

THE ANNUAL REPORT OF THE POSTMASTER GENERAL

HEARING

BEFORE THE
INTERNATIONAL SECURITY, PROLIFERATION AND
FEDERAL SERVICES SUBCOMMITTEE

OF THE
COMMITTEE ON
GOVERNMENTAL AFFAIRS
UNITED STATES SENATE
ONE HUNDRED SEVENTH CONGRESS

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FRIDAY, SEPTEMBER 27, 2002

U.S. SENATE,
SUBCOMMITTEE ON INTERNATIONAL SECURITY,
PROLIFERATION AND FEDERAL SERVICES,
OF THE COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, DC.

The Subcommittee met, pursuant to notice, at 10:05 a.m., in room SD-342, Dirksen Senate Office Building, Hon. Daniel K. Akaka, Chairman of the Subcommittee, presiding.

Present: Senators Akaka, Carper, Cochran, and Collins.

OPENING STATEMENT OF SENATOR AKAKA

Senator AKAKA. Good morning. This hearing will please come to order.

Postmaster General Potter, it is a distinct pleasure to welcome you back to the Subcommittee today. It is hard to believe that it has been only one year since your first appearance before Congress. You and the employees of the United States Postal Service have gone through more than one could ever imagine.

On September 11, 2001, the postal employees pulled together to deliver the mail to most parts of the country. Americans were comforted by the sight of postal workers that day and in the weeks to come. Unfortunately, the events of September were followed by the horrible anthrax attacks that felled two postal employees. It was a chilling reminder that ordinary people, just doing their jobs, could fall victim to terrorism. And later last year, when pipe bombs were found in the Midwest, postal employees showed their dedication and loyalty again as they continued to process and deliver the mail. General Potter, you and your employees deserve the Nation's gratitude.

General POTTER. Thank you.

Senator AKAKA. I also wish to commend you for embracing this Subcommittee's request for a comprehensive report on the future of the Postal Service. The Transformation Plan you presented our Subcommittee last May was a well conceived document. I appreciate the extent to which the plan addressed many of the fundamental issues associated with the management and operations of the Postal Service.

At our May hearing I expressed concern that the plan failed to lay out a detailed deficit reduction plan. I am pleased that we have this opportunity to continue this dialogue. I am hopeful that we can talk about time frames, how proposed cost-cutting goals will

provide adequate funds for capital needs, and how the Postal Service will deal with long-term liabilities associated with pension plans and post-retirement health benefits while ensuring the retirement security of its employees.

I was heartened by your announcement earlier this month that the Postal Service expects to begin the new Fiscal Year with a positive financial outlook of a \$600 million profit. Despite a net loss for this Fiscal Year, such good news indicates that the cost-cutting initiatives you have instituted will help to sustain a strong and vibrant Postal Service.

The financial problems facing the Postal Service remain a serious threat. However, I believe you are making progress and I am confident that those of us who care about the future of the Service will work toward the common goal of its survival.

I strongly support using existing flexibilities, whether they be for the Postal Service or Civil Service. So it was good news that the Service is seeking pricing flexibility on two fronts. One is a discount for small periodicals and the other is a negotiated service agreement for major financial institutions.

There have been other issues under discussion that affect the Postal Service. I know you were hopeful that the House postal reform legislation would have gone further and I understand that my colleague from Delaware plans to introduce similar legislation in the Senate next year. The White House is considering the creation of a Presidential Postal Commission which would be similar to legislation introduced by the Senator from Maine.

Again I welcome the Postmaster General to the Subcommittee and now I yield time to my colleague, Senator Collins.

OPENING STATEMENT OF SENATOR COLLINS

Senator COLLINS. Thank you very much, Mr. Chairman. Thank you.

I want to welcome the Postmaster General this morning, also. I had the pleasure recently of speaking before the National Association of Rural Letter Carriers at their annual convention, which was held in Portland, Maine this past summer. As I was preparing my remarks to speak to the letter carriers I was struck by the thought that it used to be that postal employees' greatest problem was biting dogs. Now it is the threat of anthrax in letters and pipe bombs for rural letter carriers. So I want to second the comments made by the Chairman as he saluted the courageous work of our letter carriers in the wake of September 11.

I look forward to hearing the Postmaster General's report this morning on the status of the Postal Service. Along with many of my colleagues, I have become increasingly concerned about the many challenges facing the Postal Service, which has lost substantial sums of money during the past couple of years. The financial crisis facing the Postal Service affects its employees and its customers and raises concerns about whether it can continue to meet its vital mission of providing universal service to every corner of our country, from Hawaii to Northern Maine. That is a challenge that the Postal Service, in my judgment, must continue to meet.

There is little dispute that the structure that we now have for the Postal Service is in need of reform. The question is: What is

the best way to accomplish the goal of ensuring that the Postal Service remains vital into this century? Legislative reform efforts have been met with stalemate in the past few years. For that reason, I have proposed legislation that would create a presidentially appointed commission composed of 11 members appointed by the President. The commission's charter of study would be very broad, extending to every relevant area. After a year from its first meeting the commission would issue a report on its findings and recommendations for postal reform. I believe that an outside look by an independent commission would be valuable to the Postal Service as it continues to implement its Transformation Plan and also to Members of Congress as we seek to write a postal reform bill.

I would note that the last time there was a major postal reorganization in 1970 it was also based on the work of a commission. While I cannot guarantee that we would have the same kinds of result, I believe that there is considerable evidence that without an independent commission it will be very difficult to get the reforms that are needed to preserve the Postal Service as a strong and vital entity into this century.

Thank you, Mr. Chairman.

Senator AKAKA. Thank you very much for your statement, Senator Collins.

I now would like to hear from the Postmaster General. You may proceed.

**TESTIMONY OF HON. JOHN E. POTTER,¹ POSTMASTER
GENERAL, UNITED STATES POSTAL SERVICE**

General POTTER. Good morning, Mr. Chairman. Good morning, Senator Collins.

I appreciate this opportunity to meet with you today to report on the progress of the United States Postal Service during the past year. That progress is a reflection of the outstanding efforts of Postal Service employees throughout the country and the entire mailing industry. The mailing industry is a \$900 billion part of the national economy that has increasingly become an integrated, interdependent national network that employs 9 million men and women. This year, working with the Postal Rate Commission and our customers, we brought about an unprecedented negotiated rate settlement. We thank the PRC and our customers for their support.

My thanks to this Subcommittee for its commitment to the Postal Service and the people it serves. Your assistance over the last year has contributed to a level of success that, in the first months of the Fiscal Year 2002, did not seem possible.

It was a year marked by challenges and measured by innovation. Throughout the horror of September 11 and the bioterrorism attacks, postal employees helped keep this Nation connected as never before. We focused on new ways to move the mail and control costs.

Six months ago when we released our Transformation Plan I made two pledges. First, I said we would continue our strong focus on improving service performance and holding the line on costs.

Second, I promised we would do our part to make the Transformation Plan a reality by beginning to make the changes that are

¹The prepared statement of General Potter appears in the Appendix on page 31.

possible now under the current legislation. In essence, our management team committed to managing the business like never before.

Today I want to give you a progress report on those commitments. First, I am pleased to report that we have pulled \$2.9 billion out of our bottom line this Fiscal Year by eliminating unnecessary and redundant programs; by taking advantage of our buying power to make smarter, more efficient purchases; and by reducing career employees through attrition by more than 23,000. Our total complement today is similar to what it was in 1995, and since 1995 we have grown by 21 billion pieces of mail and added some 12 million new deliveries. In the past year our operating group destroyed the myth that they could not react quickly and decisively in periods of declining mail volume to increase productivity and improve service.

Despite the loss of some 6 billion pieces of mail from the previous year, employees and managers rose to the challenge and delivered a positive total factor productivity as well as a 1.9 percent increase in labor productivity. From a Service performance standpoint, last fall's attacks on America required major realignments in our transportation system, including better use of our transportation partnership with FedEx and major adjustments to our national processing networks.

By the recently ended fourth quarter we reached record levels of performance for overnight, 2-day, and 3-day First-Class Mail, as well as Priority Mail. Express Mail scores are the highest they have been in 4 years.

I want to assure you that the Transformation Plan is not the plan du jour. As long as I am Postmaster General we will use the plan to advance universal mail service and America's mail. We have set transformational targets for ourselves and we are well on our way to achieving them.

For example, last week, as the Chairman mentioned, we filed with the Postal Rate Commission (PRC) a negotiated service agreement with our largest end user of First-Class Mail to incent them to grow their business and ours. This week we filed another proposal with the Postal Rate Commission that would offer small circulation periodicals a way of achieving work-sharing discounts so common with larger, mass circulation periodical mailers.

Earlier this year we worked hard with the House on a bipartisan reform bill. Although it did not move from the House Committee, we are pleased that more and more lawmakers in the House and the Senate are showing interest in the future of the Postal Service. Our on-going discussions with Congress and with the administration make us hopeful for the future.

Looking ahead, there are many things we can and will do in 2003. We are focused on four objectives. First, we will continue our commitment to improve service performance. As part of that commitment we will continue to focus on making improvements to reduce the risks our systems face against another bioterrorism attack.

Second, I am committed to continue exploring with the Postal Rate Commission alternatives to the rate-making process within the current legislation. Those alternatives include additional negotiated service agreements and phased rates.

Third, we will use our transformation strategy to grow our business by enhancing existing products and services and expanding access and convenience.

Finally, we will continue to manage our finances and reduce costs. Fiscal Year 2003 will be the second in our 5-year transformation commitment to take \$5 billion out of our bottom line.

Last year this Subcommittee raised concerns about postal debt and asked us to put together a plan for debt reduction. We responded to your concerns and focused on our finances. We went into Fiscal Year 2002 projecting a \$1.35 billion negative net income. We soon faced other challenges—a declining economy, September 11, and the anthrax attacks. As a result, we renewed our emphasis on managing our finances. For instance, we took dramatic steps to reduce expenditures. We imposed a freeze on facility construction. For the first time in postal history, we were able to reduce current year expenses below expenses of the previous year.

Much of the credit for these savings goes to our employees, who have gone that extra mile. Their efforts enabled the Postal Service to reduce our projected negative net income to significantly less than \$1 billion. We will have the final numbers later on this year. This also means that we will be in a position to reduce our debt at least \$200 million this year. The significance of this number is that last September we were projecting an increase in our debt of \$1.6 billion. This \$1.8 billion turnaround is dramatic and is a credit to all our employees and the mailing industry, who helped make it happen.

Our aggressive implementation of the Transformation Plan has positioned us to achieve a positive net income in the coming Fiscal Year 2003. This positive net income also means that by the end of Fiscal Year 2003 we will be able to further reduce our debt by almost a billion dollars. These projections reinforce the pledge that I made 6 months ago that there will be no general rate increase until well into calendar year 2004.

Keeping our rates affordable and improving service are at the heart of the Transformation Plan. The need to execute the entire Transformation Plan remains as critical today as it was 12 months ago when we faced dire circumstances.

As our Transformation Plan states, legislative changes are essential to the long-term health of the Postal Service. I look forward to working with you to bring about the legislative changes needed to assure affordable, universal mail service for future generations.

Before I close, it is imperative that I ask your assistance in another key area. As outlined in our Emergency Preparedness Plan, the Postal Service will continue to focus on reducing risk from any future bioterrorist attack. The President and Congress came to our aid earlier this year by approving the emergency supplemental appropriation of \$762 million for equipment to help reduce the risk from biohazardous material. We are grateful for this help. To that end, we are considering the purchase of biodetection and filtration equipment for use at our automated processing centers.

To facilitate the procurement of this equipment, we support and urge your support of Senator John Warner's amendment to H.R. 5005, the Homeland Security bill. This amendment would include the Postal Service among those agencies, such as the Department

of Health and Human Services and the Department of Transportation, that are engaged in procuring the means to reduce biohazardous risks. We believe this is the right thing to do.

In closing, let me thank you for your support and for helping us stay the course during this last year. And I look forward to our continuing work in the future years. Thank you very much, Mr. Chairman.

Senator AKAKA. Thank you very much for your report and your statement. I would like to ask my friend and colleague Senator Cochran for any statement he may have.

OPENING STATEMENT OF SENATOR COCHRAN

Senator COCHRAN. Thank you, Mr. Chairman.

Welcome, General, to this annual review of the Postal Service operations. I am very pleased to observe that your financial situation is better than had been expected. The deficit is lower than had been expected. I commend you for that and during the question-and-answer period we will talk about some of the things that you have done to help make that happen and what other steps could be taken to improve the financial condition of the Postal Service.

I noticed in today's paper, for example, a report on the Brentwood facility and a public meeting that was held about making that facility safe or possibly reopening it at some time in the future. It would be good to hear about your plans in that connection. We do want to be sure that the Postal Service provides safe mail and mail handling, not only for customers but for workers, as well, and we know that you have been challenged very seriously on this subject and in this area by the anthrax situation.

We hope that you will continue to keep a look out for ways to improve the efficiency of the Service and fulfill the mandate under the law, which is to provide universal service at affordable rates. We appreciate very much your hard work in the job you have, a tough job. Thank you.

Thank you, Mr. Chairman.

Senator AKAKA. Thank you very much, Senator Cochran.

Mr. Potter, we have questions and I will limit myself to 6 minutes so that we can move with questions.

Mr. Potter, at our May hearing we discussed the Service's Transformation Plan. One cost-saving measure is the redesign of the Postal Logistics Network. You said this would require reducing the number of processing centers and altering transportation routes for greater efficiency.

What is the status of your plans for redesigning the Postal Network and what facilities have been or will be closed in the near future? And how are you working with communities on these consolidations and closings? And how are you involving postal employees in these efforts?

General POTTER. The Postal Service has built and is finalizing a network integration model. Last year at this time we did not anticipate the major loss of mail, so we are in the process of reviewing some initial plans, but we have this model; it is under development. That model will be used to determine how we can most effectively adjust our network. That is the network of facilities, as well as the transportation network that connects those facilities.

This past year we have taken a very hard look at our network. We have primarily focused on annexes of our major plants and we have shut down some annexes in our plant network. We intend, once we have the network integration model analysis complete, to share that with our customers, with the communities involved, and our employees, but at the current time that modeling has not been finalized.

Senator AKAKA. The Board of Governors last month announced their support of the creation of a presidential commission to review the Postal Service. What are your views on a postal commission and continued efforts to enact postal reform legislation?

General POTTER. Personally I believe that there is a need for change, as I said earlier, and whatever vehicle gets us there is the vehicle that I am going to jump on and support. Certainly a commission, a properly formed commission with a proper agenda, can elevate the debate to the level that I believe it needs to be, and that is at the public policy level.

As we look forward and all postal administrations worldwide look forward, there is the obvious threat of hard copy mail, moving to the Internet and moving to an electronic format. We have to recognize this is a very real reality, and we have to begin to formulate public policy around what to do in the event that it happens.

In addition, the Internet and other things are helping to enhance our ability to bring services to customers. So access to the post office used to mean that you had to go to a post office. Today you can go to a bank and ATMs will dispense stamps. Grocery stores dispense stamps. We have others who do that and you can buy postage over the Internet.

So we have to look at the future needs of the American public and determine how best they will access postal services. Today you can buy stamps by mail. We believe that there is going to be a need to balance the future public policy from a standpoint of how do people access our services and what will the demand for those services be? And we need to craft and paint a picture of what a future Postal Service will be like so that I, the rest of the managers in the Postal Service, and future postmaster generals can manage toward that goal.

Senator AKAKA. The Postal Service has just announced that it expects to realize a profit in the next Fiscal Year. I know you hope to use these extra funds to pay down some of the Service's debt to the Treasury. It appears that the projected profit is based on increasing mail volume. When you testified at our May hearing you were very pessimistic about relying on increasing mail volume to generate revenue. Have your views on this issue changed?

General POTTER. Well, we are projecting for the upcoming year that there will be a slight growth in volume. The main reason that we are able to say we will be in a position to pay down debt is because of the tremendous cost-cutting that has occurred within the Postal Service, and again I have to credit all of our employees. Our productivity is up. We are expecting our productivity to stay up.

Despite the fact that I just said we are going to have some growth next year, we will still be below our Fiscal Year 2000 levels, so we are going to grow from a depressed base. We lost some 6 billion pieces of mail last year. We are going to grow from that lower

figure, but we are not going to get back to where we were in the coming year.

It is a combination of improvement over a depressed base and the fact that we are being very frugal and being very cost-conscious. The combination of the two will enable us to have a positive net income, and currently we think it will be almost a billion dollars that we will be able to pay toward our debt next year.

Senator AKAKA. Thank you very much. My time is up, so I now ask for questions from our Ranking Member, Senator Cochran.

Senator COCHRAN. Mr. Chairman, I notice one of the first questions you asked was about postal reform and whether or not a major initiative for a commission would be in order and since that is Senator Collins's bill, I think I will defer to her for any questions about that—she was here before I was, anyway—to go ahead and ask questions that she might have.

Senator AKAKA. Senator Collins.

Senator COLLINS. Thank you very much and I thank my colleague from Mississippi for his usual graciousness.

Postmaster General Potter, I want to follow up on the issue of the commission, though perhaps I do so with some trepidation because your initial response to the Chairman may be as good as I am going to get on this.

Given the failure of postal reform legislation during the past few years, even this past year where there was so much discussion in the House committee and a lot of input and yet still the bill did not even make it out to the House floor, do you not think that a commission would be helpful as far as taking an independent look at the Postal Service and assisting you, as well as Congress, in coming up with some recommendations for us to consider, for you to consider, that might help us implement postal reform?

General POTTER. I do think an independent look at the Postal Service would be helpful, as I said earlier. I believe that there are some major public policy issues that have to be addressed.

On the other side of the equation though, I do not want to give the impression that should there be an effort to have some legislative changes that could help us in the short run, that I would be opposed to them. So the bottom line is I would like to see change. I understand the benefits that a commission can bring, particularly if it is an independent commission. And if they step back and look at the big picture and the role that the Postal Service has in terms of serving America and the public policy issues that would naturally come up around universal service, as an example, I do think a commission could be helpful.

Senator COLLINS. Thank you. Recently I met with a group of more than 20 businesses in Maine that ranged from printers to small catalogue companies to L.L. Bean, all of whom rely heavily on the Postal Service and all of whom expressed great concern to me about having more stability and predictability in postal rates. One of the catalogue companies, for example, told me that the cost to mail his catalogues now greatly exceeds the cost of the paper on which the catalogues are printed. Another told me that the recent rate increase had created great problems for its company because he had already set his prices for his products in the catalogue and then there was the unexpected rate increase.

What are your plans for ensuring more predictability and more stability when rate increases are necessary? What a lot of these businesses told me is they understand there are going to be rate increases but it is when they are unexpected, more frequent, or higher than they can plan for that they really create tremendous strains for their businesses and for the employees for which they are providing good jobs.

General POTTER. Well, let me address the stability part of the question first. I believe that obviously it is a matter of implementing the Transformation Plan. We have set some very aggressive targets for ourselves in terms of productivity, in terms of cost containment, and we have to stay the course. If our costs remain relatively stable, then prices will be lower and predictable, so that is the first step in the process.

Second, I have said and repeatedly have said that I would like to have a discussion with customers about phased rates. It is a concept that is used in other countries. Some customers have come to me and told me that when they deal with Canada Post, for example, that they know what their rate increases are going to be 2 years out. When you look at our competitors, they raise their rates on an annual basis.

We have a system, again a legislated system, that has the Postal Service raising rates every 2 to 3 years and in the process, what happens from an operational standpoint is that we have a peak in volume just before our rate is increased. That is because our rates are affordable. Once the rates are increased, elasticity kicks in on some of our products, so our volumes decline. Therefore, we have a staffing issue on how we deal with those peaks and valleys.

What we would like to do is get to the point, through some adjustments in the way we are currently changing rates, where we can offer and project rates, and we call it phased rates, annualized rate increases. It helps obviously customers; they can plan their budgets several years out. And it would help the Postal Service in terms of our efficiency. We would not have to deal with peaks and valleys in our mail volume.

We are very eager to do that. We are engaged with customers and the Rate Commission to talk through how we could use the current process to arrive at that type of situation.

Just this past week, I had conversations with a number of customers about elevating that discussion and seeing what we can do in the short run to advance that.

Senator COLLINS. I want to turn to one other area. As you may well recall, the Postal Service in Maine has had several cases in Portland of sexual harassment in the past few years and I know this has been of great concern to you, as well. But I was disturbed to read in the Inspector General's Report that she had initiated an audit of the Postal Service's sexual harassment prevention program and encountered, in her words, "considerable resistance from management."

This is of great concern to me because I know the Postal Service had initiated some training programs in Portland, Maine that I was putting a great deal of hope in and if the IG is finding management resistance to effective implementation of the sexual harassment program at the Postal Service, that is very disturbing.

I would like you to respond to those criticism and tell me what the Postal Service is doing to ensure that the very unfortunate and unacceptable incidents that we experienced in Maine do not occur again.

General POTTER. The Postal Service is very aggressive in dealing with sexual harassment, dealing with equal opportunity. We do not take those matters lightly. We are very aggressive in Maine. There has been a change in management. There have been a number of training efforts that have been under way. We are not going to accept sexual harassment anywhere in the country.

There can be differences of opinion between the Postal Service and others who review our work in terms of how we might implement something. I am focused on getting the job done and making sure that nobody is a victim of harassment and, if they are, that they do not have any fear about advising the proper authorities that a situation occurs and that action is immediately taken.

Oftentimes we can get into the semantics of how somebody might do something, and I would prefer to focus on the action of dealing with the matter. I believe that we have responded aggressively in Maine, and we are going to respond aggressively anywhere in the country where a problem exists.

Senator COLLINS. Thank you.

Thank you, Mr. Chairman, and thank you, Senator Cochran.

Senator AKAKA. Thank you.

Before I call on Senator Cochran for questions I would like to ask the Senator from Delaware for any statement you may have.

OPENING STATEMENT OF SENATOR CARPER

Senator CARPER. I do have a statement. I think what I would like to do is ask that it be entered for the record and I just look forward to having the opportunity to ask some questions of the general. Thank you. It is good to be with all of you.

[The opening statement of Senator Carper follows:]

PREPARED STATEMENT OF SENATOR CARPER

Thank you, Mr. Chairman, and thank you, General Potter, for taking the time to testify before this Subcommittee again on the state of the Postal Service.

As I've mentioned in the past, this has been a rough year for the Postal Service and its employees, possibly the roughest ever. In the past few weeks, however, we've heard that, despite another year of declining mail volume and declining revenue, the Postal Service's budget deficit will be significantly smaller than originally projected. What everyone feared could be as high as \$4 billion a year ago was reduced to \$1.5 billion, then \$1.2 billion. Now, we hear that it could even go below \$1 billion.

The Postal Service does not find itself in this position because people are giving up on e-mail and electronic bill pay and sending their correspondence through the mail again. As we all know, and as I think the Postal Service admits itself, consumers' move from mail to newer, electronic means of communication is still happening and will continue to happen. The Postal Service finds itself with a rapidly improving short-term budget outlook because it has engaged in some dramatic cost cutting.

As the Postmaster General pointed out in his testimony, billions of dollars were taken out of the system this year. The freeze on new facility construction was continued and further automation was encouraged. The biggest cuts, however, appear to have come through workforce reductions. About 23,000 positions have been eliminated through attrition and work hours have been reduced by 77 million despite the fact that the Postal Service is delivering to nearly 2 million more addresses than it was last year. I understand that the Postal Service plans to continue these kinds of cuts next year.

I'm happy to see the Postmaster General making the Postal Service more efficient. I think it should be clear to everyone, however, that the kind of cost cutting the Postal Service has engaged in this year cannot be sustained and will not be what makes the Postal Service a fiscally sound entity in the long term.

As the economy begins to pick up, the Postal Service may very well see an increase in volume as the Postmaster General predicts. At the same time, however, the number of addresses they are required to deliver to will continue to increase. I don't know what effect this year's workforce reductions and the continued facilities freeze is having on service right now, but if the Postal Service intends to continue balancing its budget by cutting employees and avoiding new facilities construction, it will probably have some serious difficulties meeting its current delivery standards, and even its universal service mandate.

The Postmaster General is probably doing all he can right now to keep the Postal Service afloat. We need real reform of the way the Postal Service does business for him to be able to go any further. Whether it comes from Congress or from a Presidential Commission, postal reform is still necessary. I think it should, and can, come from Congress and I hope this Subcommittee will work with General Potter next year on this issue.

I look forward to hearing from General Potter today and to learning from him exactly what kinds of flexibilities he thinks this Subcommittee needs to give him and his successors so that the Postal Service can get by in the electronic age.

Senator AKAKA. Senator Cochran.

Senator COCHRAN. Mr. Chairman, thank you.

I understand that mail volume has substantially decreased this year, as a matter of fact, to a greater extent than we have seen since the Great Depression in the 1930's. My question is what has this done in terms of revenues and the financial condition of the Postal Service? And do you have any information about whether we are on the rebound and is volume picking up? Is this something that is going to take care of itself or do you have to take specific steps to try to turn it around?

General POTTER. The Postal Service did lose more volume this year than it ever has in its history, including during the Great Depression. Volumes dropped some 6 billion pieces of mail. In the first quarter of last year they were down some 5.5 percent. We have seen them gradually come back. In our last accounting period, we saw less than a 1 percent drop in volume from the previous year.

What we did throughout was we adjusted the use of our resources to match this lower workload. In fact, we went beyond that. If we had just matched it, our productivity would be flat. Our productivity was up. So we aggressively managed our costs.

What do we have to do? We have to focus on growing the mail back. So as much as we focused on costs, moving forward, we have to focus on growing volume. That is a matter of working with our customers to understand what their needs are, to make postal products more effective for them in their business, whatever that business happens to be. We are working as hard as we can to make that happen.

And long-term, in terms of people using the mail, we have to assure them that we are going to manage our finances such that they will not see tremendous increases in price. And that is what we have laid out in our Transformation Plan and that is what we are doing as we speak.

Senator COCHRAN. I notice also you have had a freeze on capital spending in effect for the past 2 years. Can you tell us what impact this has had on postal operations? Has it had a serious effect and maybe been one of the reasons you have lost volume?

General POTTER. I do not believe that the capital freeze has had any impact on the Postal Service's volume. The volume was lost because of the economy, because of September 11, because of anthrax attacks and a very weak advertising industry. I think we all know that advertising was probably more dramatically impacted last year than anybody, and there are a lot of reasons why that occurred.

But as we look forward, we are taking, I believe, the necessary steps to manage our costs, to create products and services that people will use the Postal Service for.

I am sure that at the beginning of the Fiscal Year there were a lot of concerns about our service levels. And, as I said earlier, we have made dramatic improvement. We are now beyond where we were a year ago. We are now at all-time highs on First-Class Mail, Priority Mail, and our Express Mail scores are the best they have been in the last 4 years.

So we believe we are delivering a quality product. Those people who had some concerns about the Postal Service last year should try us again. The mail is moving. It is getting home on time. And we believe we can effectively serve business and the American public.

Senator COCHRAN. I think a lot of people do not realize the impact that this anthrax business and the screening and special precautions that have been implemented, the effect that has had on delays. For a while we were waiting months literally for the delivery of mail to our offices here in the Senate but I notice that has changed substantially in the last month or so.

Do you foresee a time when we will actually be getting mail in the same way we used to without these long delays?

General POTTER. Well, Senator, I would like to point out for the people watching out there that we do have a special step that we take for the mail that is coming to the Congress and other high-threat receivers of mail. So the service that you are seeing here in the Congress is not what the rest of America is seeing and that is not measured as part of the system I just talked about.

When we first were hit with anthrax, we had to create a procedure to irradiate mail for the Senate and the House and other government agencies, and initially that took some time. Today it is adding about 2 days to 3 days to the process of delivering mail to the House. So I would encourage those that have mail for the Senate, send it. We do not want you to hold that back.

Senator COCHRAN. Do not go that far. [Laughter.]

General POTTER. Send plenty of it.

But back to the issue, we did have procedures. We did have some issues that we did have to work around, and it goes beyond just irradiating mail. We have two facilities that are still closed—the Brentwood facility and the Trenton facility. And our people did a phenomenal job in putting together work-arounds so that we can deliver mail to those communities served by the Trenton facility or Belmont facility, as well as the facility here in Brentwood. Those people are seeing mail delivered in a very timely manner.

Our employees have had to make sacrifices. We had people who worked in those buildings who are now commuting to other locations so that they can sort, process, and in some cases we had car-

riers in those buildings, as well, so they could receive their mail and bring it out to their customers to be delivered.

Our employees have risen to the challenge. We are delivering mail, as I said, better than we ever have in the past, and we are going to continue to do so because we know without service, there is no Postal Service.

Senator COCHRAN. Right. Thank you. I notice my time has expired, Mr. Chairman.

Senator AKAKA. Thank you, Senator Cochran. Senator Carper.

Senator CARPER. Thanks very much for joining us today and for your stewardship and for the work that is going on by Postal Service employees throughout the country.

I must say it seems like we were here about a year ago and we were talking about a deficit for the current Fiscal Year which ends on September 30. I seem to recall that the projected deficit was as much as \$4 billion. Is that about right?

General POTTER. Yes.

Senator CARPER. And now if I understand these figures correctly, we are now looking at a deficit for the Fiscal Year that could be as low as \$1 billion, maybe even a bit lower?

General POTTER. It is going to be a bit lower, yes.

Senator CARPER. And we are looking at a situation in the next Fiscal Year which starts on October 1 where we could see a profit of as much as a half billion, \$600 million?

General POTTER. Hopefully more than that.

Senator CARPER. I missed your testimony. I have not read it; I will read it later, but I understand that a fair amount of that is attributable to cost-cutting that is going on and I am going to ask you just to take a couple of minutes and share with me why you have been able to make such a dramatic reduction in this year's deficit and look forward to a profit for next year. Just talk to me a little bit about the cost-cutting that is going on. I understand there are a number of positions that have been eliminated but I understand you have done that through attrition. If you could just talk to me about how that has happened, with a focus on where there has been attrition or some other methods used. And maybe if you could talk a little bit about how your freeze on capital construction has played into your ability to curtail your costs.

General POTTER. Well, not to tell too long a story, we went into the year with a deficit plan of \$1.35 billion. In December, we were looking at revenue decline of \$2 to \$2.5 billion. We were looking at costs related to bioterrorism.

So we embarked on a plan to try and mitigate as best we could that projected deficit or deficit that could have gone to \$4 or \$5 billion. And the way we went about that was, first of all, trying to match our use of resources, in one case work hours, to a lower workload. We had 6 billion pieces less mail, so you do not need the same number of employees.

Senator CARPER. Is that an annualized total?

General POTTER. That is an annualized total. You do not need the same number of people to work what we had planned to be, over 210 billion pieces of mail, as to work 200 billion pieces of mail. So we modified our use of work hours based on this lower workload that we received.

In addition to that, we went beyond that, and we actually have seen productivity improve. So had we just managed to the lower workload, we would have seen a flat productivity, but we went beyond that.

And our plan coming into the year was to reduce some 30 million work hours and some 10,000 to 12,000 people. All of our reductions were a result of attrition. We have not laid off any of our craft employees—no carriers, mail handlers, or clerks.

We also did not limit ourselves in terms of cost-cutting to simply work hours. We cut programs, some that were redundant, some we sat back and said do we really need this? Can we afford to do that this year? We cut back. We looked at a lot of our contracts, supplier contracts, and sought ways to reduce our costs.

So we eliminated some redundant transportation. We had lower workload. We could tighten up our transportation.

We sought help from our customers. Now keep in mind part of our result is the fact that our customers agreed to an unprecedented rate settlement. That rate settlement allowed us to raise rates in June versus October. That contributed \$1 billion to this turn-around.

Senator CARPER. Over 4 months?

General POTTER. Over 4 months.

Senator CARPER. So that would be \$3 billion on an annual basis?

General POTTER. It is more like \$5 billion. It is the lower part of our volume period. It is about a fiscal quarter, and it is our low volume period.

So they stepped up to help us with \$1 billion. Part of our projected deficit were costs that we thought we were going to incur and did incur as a result of the terrorist attacks. And the Congress helped us and appropriated monies for us.

So when I look at the result, I truly say that it is the entire community that came together to deal with this. By the way, we started at the top with our cost-cutting. We eliminated 20 percent of our officers. We eliminated some 800 jobs at headquarters. We eliminated 20 percent of our mid-level area officers. We eliminated 10 percent of our administrative positions throughout the country.

So this was an all-encompassing effort. Our employees made the largest contribution in terms of that improved productivity. Our managers cut back programs, tightened up in terms of the amount of personnel that they had. Our customers came to the table and delivered \$1 billion, and the Congress stepped in and helped us with \$750 million.

I do not want you to think it was just postal managers. Everybody recognized the dire circumstances and stepped in and helped us.

Senator CARPER. Talk to us a little bit about the freeze on construction costs, which is something that I suspect you can do for a while but not forever.

General POTTER. We placed a freeze on construction costs other than for emergency purposes. Any time we have a life safety issue, we spend money, whether that is a leaking roof or if there is an act of God that might damage a building, we go out and repair it.

One of the things that we have learned over the past year is that there were ways to more effectively utilize space in post offices. In

terms of our future plans, we are balancing the ability to tighten up space, as well as growth in communities. We recognize that we are going to have to spend, and our plan for next year is to spend some monies, a limited amount of monies, in those high-growth areas where there is need for new construction of postal facilities. We are looking at facilities, some construction of postal facilities where there is a return to the bottom line.

Senator CARPER. Mr. Chairman, my time has expired. If we have a second round of questions for the Postmaster General, I would love to ask some more. Thank you.

Senator AKAKA. Thank you very much.

Postmaster General, the lack of financial accountability in business has received national attention, especially since the Enron scandal occurred. Congress responded quickly and passed a bill focused on financial accountability.

Given that the Postal Service is essentially a \$70 billion business, I have two questions. First, do you believe the manner in which the Board of Governors operates should be changed? And second, do you believe the Postal Inspector General should be a presidentially appointed and Senate-confirmed position to ensure independence from the postal management?

General POTTER. First regarding the Board of Governors, I believe that the structure of the Board of Governors is one that works. They are an independent body. They are presidentially appointed. They are very distinguished men and women from around America. So I think that the process works. They have an outside, independent auditor, and they assure the fiscal responsibility of the Postal Service.

In fact, recently they had an outside consultant come in to look at their practices, particularly when it comes to their audit and finance committee. What they found was that their practices are among the best in the Nation. So I believe that the body as structured is effectively what other boards throughout the country would do, whether it is a private concern or a Federal concern.

Regarding the inspector general, I would leave comment to the Board of Governors, who select the inspector general. Right now they are responsible for the selection of the inspector general. She reports to them, and I would prefer that they comment on that matter.

Senator AKAKA. Thank you. The Office of Inspector General and the Defense Contracting and Auditing Agency reviews have identified millions of dollars in potential savings in their audits. What have you done to ensure that these identified cost savings are realized? Does the Inspector General participate in the settlement negotiations?

General POTTER. We have created in the last year an office within our Finance group to work as a liaison between the Postal Service and the Office of the Inspector General to ensure that all findings and all opportunities that are identified by the inspector general are implemented. We are grateful to the inspectors general when they come up with findings of fraud and other things that will help the bottom line of the Postal Service. We have put in tracking systems to make sure that happens.

Senator AKAKA. The Postal Service and the Postal Rate Commission hosted two rate summit meetings over the summer. As you noted in your testimony, the Service filed a rate case with the PRC for a negotiated service agreement with Capital One. The Board of Governors also approved the filing of the second case involving magazine publishers.

Can you explain what benefits the Postal Service will receive from these rate initiatives and what other initiatives are you planning?

General POTTER. First let me thank the Chairman of the Postal Rate Commission, George Omas, for all of his help this past year. The rate settlement was unprecedented, and we are working to build a stronger and better relationship between the Postal Service, the Postal Rate Commission and our customers.

The negotiated service agreement for Capital One is designed to incent them to keep mailing First-Class Mail. They have solicitations that they send out to customers to try and get them to use their credit card, and one of the things that they did last year was use First-Class Mail to send out a portion of those solicitations. We would like them to stay in First-Class Mail.

So that is strictly designed to increase the amount of First-Class Mail that we receive. The contribution of First-Class letters to the bottom line versus their alternative, which is Standard A letters or bulk business mail, is much greater with First-Class Mail, so we would like them to stay in the First-Class Mail for their solicitations. The NSA is designed to do that.

When it comes to the periodicals, many periodical mailers talk about the difference in price between a very large mailer and a smaller mailer. The reason that it is a lower price for the big mailer is because they are able to prepare mail so that it moves through our system rather rapidly. In fact, it bypasses a number of handlings in the system.

What we have designed with the proposal to the Rate Commission is to enable multiple smaller mailers to combine their mailing such that they can bypass steps in our system and therefore lower their costs and in the process, lower the price that we have to charge.

We are working with other mailers and other entities to determine whether or not there are other opportunities like I just described. Our goal is where there is a mutual benefit, meaning there is a benefit to the Postal Service and to the mailer, to either incent growth and/or to change a process so that it is more economical for the handling of mail. We would like to engage in that process.

We are looking forward to other negotiated service agreements. I can tell you there are a lot of mailers out there who are very enthusiastic about it. I can tell you from the Postal Service's standpoint we are also enthusiastic about moving down that path.

Senator AKAKA. Thank you very much. Senator Cochran.

Senator COCHRAN. Mr. Chairman, thank you.

I understand, General, that the Postal Service is studying whether to close or consolidate some postal facilities. What is under consideration and how do you think this may affect the Service's future capital investment needs?

General POTTER. Today we are considering the consolidation of our mail processing centers. We have almost 300 centers around the country. We have seen a change in the mix of mail and by that I mean where mailers used to bring in mail locally for mail to be sent throughout the country, we have seen that a lot of them are bypassing the originating facility and bringing it to destination. The workload in some of those receiving facilities has gone down.

We have seen a lot of business communities move to electronic messaging, electronic payment, so we have seen a decline in volumes in certain facilities around the country.

At the same time that we have seen declines in pockets around the country and change in mailing behavior, we have also improved the efficiency of those operations by introducing automated equipment. And the combination of all three things has created a situation where we have some underutilized buildings and where there are efficiencies to be gained by consolidating operations.

As I said earlier, no final decision has been made on network consolidations. We are currently modeling the alternatives that are available to us. We are trying to factor in not only the current volumes that we have, any changes in mail mix that might be planned by our customers, as well as growth that we might anticipate in different areas around the country.

Senator COCHRAN. To what extent will you involve local communities in these plans or the announcements of plans and how to deal with that in terms of local interests?

General POTTER. Well, part of our consolidation plan includes a thorough analysis of service to make sure that there is no diminution of service to customers involved. It addresses where mail might be deposited to assure that customers do not have to move mail any further than necessary, so they can deposit mail and they can do it conveniently.

We do involve customers in that process to tell them how things are being changed. We also involve customers because if we eliminate a node on a network, we must tell them where to deposit mail.

As far as the American public is concerned, it is transparent. The post offices that they buy stamps in, the letter carrier that comes to their door, they are unaffected by the changes that happen within the network. In terms of the general public, they do not see a change and our goal and our commitment when we make those changes is to maintain the level of service that we provide.

Senator COCHRAN. What will happen to the employees that work in these facilities?

General POTTER. There will be no lay-offs. In some cases we will be able to make these changes primarily through attrition. We might be able to downsize without having to affect the location of where someone works. Worst case scenario, we might have to excess employees out of that facility and move them to neighboring facilities where there is work.

There is a process within our contract, our labor agreement, on how we deal with a situation where we find ourselves with excess employees, and that is the term that is used in the contract.

Senator COCHRAN. Some have expressed concerns about the Postal Service awarding large sole source contracts, such as contracts with Goodyear and FedEx. Is the Service increasing its reliance on

sole source contracting? Is this having an adverse effect on open competition? And is consideration being given to expanding contracts to include not only air transportation but possibly ground transportation?

General POTTER. Like any other business in America, we are looking to take advantage of our buying power, and one of the ways is to consolidate multiple contracts so that we can get the best price that we can from our suppliers.

Sole source is not the sole mechanism to do that. We compete those contracts with one or two exceptions. Those major contracts are competed. The best price is sought out, and that is what has enabled us to make a big contribution to the financial results that you see in the past year.

Senator COCHRAN. One of the initiatives included in the Transformation Plan is a private employee-owned company to investigate equal employment opportunity complaints. Can you give us an update on the status of this initiative? And does this have the potential for approaches in other areas?

General POTTER. We are considering entering into negotiations with a company to determine the feasibility of moving to an ESOP, where our employees work for a private company to investigate EEO matters. We believe it is prudent to have an independent group investigating EEO complaints and we are looking at that as an alternative down the road for other areas, but we do not have any definitive plans. Certainly, it is an option that we look at when we consider future costs of anything that we do.

Senator COCHRAN. Thank you, Mr. Chairman.

Senator AKAKA. Thank you very much, Senator Cochran. The senator from Delaware, Senator Carper.

Senator CARPER. Thank you, Mr. Chairman.

When my time expired, General Potter, I was asking about what you have done in order to hold down your costs on the capital construction side. You have not curtailed dramatically your investment on the capital side where productivity is enhanced. Is that a fair statement?

General POTTER. That is very fair. We continue to spend approximately \$1 billion a year to invest in equipment or other product-enhancing investment opportunities. We are very concerned about the future of the Postal Service, and we want to make sure that we do not make any short-term decisions that would affect our future ability to have affordable prices or to provide a high level of service. So we have continued to invest in those projects that give us return.

Senator CARPER. Give us just a couple of examples of the kinds of investments that you have made in the last year to enhance productivity and maybe some examples of what you would like to turn to next.

General POTTER. Well, probably the best example of a machine that has enhanced our productivity is the automated flat-sorting machines that we have.

Senator CARPER. Automated flat-sorting?

General POTTER. Automated flat-sorting machines. We have the ability today, similar to letters, where we feed mail through a machine that automatically feeds the mail. It reads the address using

optical character-reading technology. Where it cannot read an address, it sends that address to a keying station, and there are some 30 around the country, where people key the flat mail, so that we can properly sort the mail. We have some 530 machines that we have deployed over the last several years, and they have made a dramatic difference not only in our costs of handling flats but a dramatic difference in terms of our ability to provide a high level of service for flats.

Senator CARPER. When you talk about flats, what all does that include? Does it include catalogues, stuff like that? Magazines?

General POTTER. A flat is anything that is greater than a letter. It is a magazine. It is a catalogue. It is a large manilla envelope. Basically if it is beyond 6½ inches high and up to 10 inches wide, it is a flat.

Senator CARPER. Are there more productivity gains to be made in that area with respect to flats?

General POTTER. There are. We are continuing to move more mail onto this equipment. We have not exhausted all of our opportunities. We are taking mail out of small post offices and automating it. We sort the mail down to the carrier route on these machines. Initially we focused on the mail that was already being sorted in the mail processing plants. So there is more opportunity to better utilize that equipment.

We have just recently signed an agreement for new package sorters. The package sorter will do traditional packages of mail. It will also do bundles of flat mail and other bundled mail so that we can break down palletized bundles of mail.

In the future we are looking at equipment that perhaps one day could marry the letter mailstream, the smaller envelopes with the larger envelopes, and put that mail into walk sequence for our carriers. That technology is far down the road, but we are making investments today in terms of research and development to try and develop a prototype that will be effective.

Senator CARPER. Good. You spoke earlier of these negotiated service agreements and do I understand you have recently entered into one with—is it Capital One?

General POTTER. Well, we have agreed to present one to the Postal Rate Commission.

Senator CARPER. How does this process work, please? How does the process work with respect to a negotiated service agreement? You negotiate with in this case the customer and then you present it to the Rate Commission?

General POTTER. Yes, we negotiate with customers. Customers can bring ideas to us. In this case Capital One brought an idea about, and we had discussions with them about how to keep them in First-Class Mail and incent them to keep as much of their product in the First-Class mail stream as possible.

We negotiate with them to determine what it would take to incent them to do that, and we evaluate whether or not there is a return for the Postal Service. Is it worth our while? What will it do to other customers? We do not want to enter into an agreement with one customer that would disadvantage other customers or perhaps cause other customers' rates to go up.

So we go through a very elaborate process. We have been trying to do this now for about 3 years, and we finally think we have worked out a formula that works. We put together a case with the customer and make a proposal to the Rate Commission, and we go through a litigation process literally where others have the ability to come in and comment on what is being proposed.

Senator CARPER. How does that process now work with the Postal Rate Commission? Is there a procedure, expedited procedure? Do they take as much time as they want?

General POTTER. Senator, they have up to 10 months to render an opinion on the case. They make a recommendation. That recommendation goes to the Board of Governors. In their recommendation they can modify what we propose and then the Board of Governors has a number of alternatives. They can implement what the Rate Commission recommends. They can send it back. And ultimately it is the Board of Governors who will make a decision based on the recommendation of the Rate Commission.

Senator CARPER. Ten months? My first reaction is that sounds like a long time.

General POTTER. It is a very long time, and we hope that we can expedite this through the process but legally, I believe, they have up to 10 months.

Senator CARPER. You say legally. Is that set forth in law? Do you understand it is set forth in law?

General POTTER. As I understand it, yes.

Senator CARPER. Several people in the audience are saying yes.

General POTTER. We have had numerous instances where we will propose something to the Postal Rate Commission and they will expedite it. But they are legally not bound to do that. Any time we take something to the Rate Commission we both mutually try to move whatever the proposal is through as quickly as possible. The only legal limitation, though, is a 10-month limitation.

Senator CARPER. Thanks.

My time has again expired, Mr. Chairman. Thank you. If we have another round I would love to ask a couple more questions.

Senator AKAKA. You certainly may.

Postmaster General, you answered this question in part in your response to Senator Cochran but I would like to ask for further clarification because of some disturbing reports that we have been hearing. This has to do with the closure of post offices.

First, when will you decide which post offices will be closed? And second, when will these closings take place? There have been reports that they will happen right after the November election. Can you respond to those questions?

General POTTER. Well first of all, if I misspoke, let me clarify. It is illegal to close a post office. There is a post office closure process that we have embarked on. We do not have a master plan to close post offices. So I want to make that abundantly clear.

When I was speaking to Senator Cochran I was referring to mail processing plants, plant operations. We have some 300 around the country. As I described, there is an opportunity to consolidate the processing. It might be just that we consolidate tours rather than close buildings. In fact, in most cases we would probably consolidate tours from two buildings into one.

We will not close or do any consolidations in 2002, calendar year 2002. Again we are working with these models. We have people who are drafting proposals from around the country. We are going to evaluate them at headquarters, and we are going to make sure we take the necessary steps to implement them properly.

I do anticipate that there will be some consolidations in calendar year 2003.

Senator AKAKA. Thank you for that clarification.

Your emergency preparedness plan indicates that you will need \$799 million in Fiscal Year 2003 to pay for expenses related to the prevention of future bioterrorist attacks. Does your financial plan anticipate these expenses will be paid by the Postal Service, by postal customers, or through an appropriation request from Congress?

General POTTER. Well, the answer is easy on that one. We would prefer an appropriation from Congress.

Senator AKAKA. During this past year Congress appropriated \$35 million to cover the cost of decontaminating the facilities affected by the anthrax attacks. The Postal Service just completed its final systems test at Brentwood facility.

What is the time frame for cleaning up Brentwood and where are you on the clean-up at the Trenton mail processing facility? Do you know when these facilities will be reopened?

General POTTER. Senator, we are moving as quickly as we can to reopen our facilities in Brentwood and up in Trenton. We are trying to do it in a very diligent way in the sense that we want to take all precautions so that we are not doing anything that potentially could harm the communities that surround those facilities. We want to make sure that we take care so that the facilities are properly cleaned so that you and I could walk into those facilities with confidence that they are not a threat to our health. If we are unable to do that, our employees should not go back into those facilities.

My understanding is that we are probably going to have another test at the Brentwood facility before we move ahead for clean-up. Again we are working with other Federal agencies. We want to do everything that is necessary to assure the safety of those who are going to fumigate those facilities and treat those facilities, the surrounding communities, and our employees when they go back into those facilities.

I wish I could give you a time frame. The clock keeps moving back but it is moving back for proper reasons. It is because we are taking other precautions, and we are making sure that it is done right and that we do not have any harm. But our goal is to clean Brentwood as quickly as we can. The same team that is being used in Washington, DC, will then move to New Jersey, and it will conduct a clean-up of the Trenton facility.

Senator AKAKA. The Postal Service emphasizes the need to involve the four postal employee unions in initiatives relating to the Transformation Plan. Could you please provide us with an update on how this is going and give specific examples of the progress that has been made?

General POTTER. We have been working very closely with our unions and it began last year with anthrax. We have a Mail Secu-

riety Task Force that meets on a regular basis to discuss the parts of the Transformation Plan that deal with the protection of our employees and the reduction of risk to our system from biohazardous threats.

In addition to that, we meet on a regular basis. I personally meet with the heads of the four unions and three management associations to discuss where we are going with the Transformation Plan. I was very excited that the National Association of Letter Carriers has come to an agreement with us to work together on the implementation of the Transformation Plan. It was announced at their convention last month, and I want to thank their president, Vincent Sombrotto, for his support. And we are looking forward to working with that union and all the unions on the Transformation Plan.

And it goes beyond just legislative change. Part of that agreement with the NALC talks about the flexibility that is necessary to meet the needs of the American public moving into the future.

So I am excited by the fact that these conversations even take place. Years ago that would not have even been the case. But I am also excited that we are seeing progress and we are coming to common understanding on a lot of the issues. We will not always agree about everything but I do think we have a common goal and a common desire for the Postal Service to be successful in the future.

Senator AKAKA. Thank you very much. Senator Cochran.

Senator COCHRAN. Mr. Chairman, thank you.

General, in the Postal Service's Transformation Plan it is stated that you plan to develop some new products and services. Can you tell us what new products and services you are considering?

General POTTER. I can give you an example of one that was kicked off on September 22 and that is a product called Confirm. What Confirm enables a customer to do is to put a code—we call it a planet code—put a code on their mail that is read by our optical character-readers on bar code sorting equipment and other equipment so that they can deposit their mail and they can track it through our system.

Oftentimes in the past people have had to call up postmasters to say, "Did you see my catalogue? Did you see my periodical?" And what we have built is a system that allows codes to be read, no labor involved, same optical character-reading capability, so people will be able to track their mail through the system.

The benefits to the customer are many. We have some customers who are using this, insurance companies and others, who have bills that are outstanding from customers. Before they mail a second piece to say you are in arrears and you failed to meet your payment, they can check to see whether or not that customer has sent a response.

And there are other things that make it a better product, whatever they use it on, for them. For example, there are customers who send out advertisements. They know when the advertisement hits a home so that they can set up their fulfillment response and better predict what is going to happen in terms of their use of resources.

So that is one example of a product where we have a product, you pay a fee, but it enhances one piece of our core business, in that case letter mail or flat mail.

Senator COCHRAN. Did you realize any net income from any new products and services during this current Fiscal Year? If so, how much income do you—

General POTTER. No, we did not.

Senator COCHRAN. Have you taken any steps to improve the financial information relating to costs and revenues associated with new products and services, including e-commerce?

General POTTER. Yes, we have raised the bar in terms of our financial reporting, and we deal with those products on a separate basis. A lot of that financial analysis has led us to curtail and eliminate some products, particularly e-commerce products, that we had offered.

So as we introduce new products we put in a very tight financial monitoring system and then we evaluate the business plans that were developed around those new products. We will be able to make evaluations, I think, in a more timely way to determine whether or not we continue on with a product or we eliminate a product.

Senator COCHRAN. Speaking of discontinuing new products or services, have you discontinued any new products over the past year and how have you reached those decisions as to whether something is making money or going to make money or is losing money and should be abandoned?

General POTTER. Well, in the past year we have eliminated Net Post Certified, Poste CS, a couple of our electronic commerce products. We have used the financial data that we have to reevaluate the relationship that we have with others on some of these products. For example, our eBillPay product, we have totally revamped our contract such that today we allow people to access that product using our website but our total investment is one staffer to manage the system, the process, and ensure the integrity of the system. But we literally just allow people to use our brand name on that product. We do the due diligence to make sure that it is an effective product.

Now we anticipate that we are going to have net income from that, positive net income from that, as a going concern into the future as a result of the changes that we made.

Senator COCHRAN. Are you satisfied that you are evaluating the performance of new products and learning why you are or are not making money with some of these new products?

General POTTER. I am satisfied that we have made tremendous progress in our analysis. I cannot tell you that I know for sure why we make or do not make money. I think a lot of the marketplace dictates that. We are a lot smarter than we were a year ago. I think we are going to continue to get smarter as we move into the future. We are going to make very crisp decisions about whether or not a product is effective for us or is not effective and we are going to abandon those that simply do not help our bottom line.

Senator COCHRAN. Are you concerned about questions regarding whether the Service should be spending resources to provide prod-

ucts and other services that are already provided by private sector companies?

General POTTER. I am not concerned because our focus is going to be, while I am Postmaster General, products that enhance our core products. So we will look at products that enhance letter mail, flat mail, and packages. As I just described, Confirm is a new product but it is strictly related to our core mission of delivering hard copy and delivering package services in America. So as we move forward we are going to look to make sure that there is a linkage between the two.

Senator COCHRAN. Thank you. Senator Carper.

Senator CARPER. Thanks.

I arrived a few minutes late and I missed your testimony. I was in an earlier meeting in my office on Amtrak. Just about every Friday, we pull interested parties together and discuss the figure of passenger rail service in our country.

One of Amtrak's significant customers is the Postal Service. Would you just take a minute or two and describe the nature of that relationship, your satisfaction with that relationship, if you see it diminishing, if you see it growing, if there is something that Amtrak needs to be doing to be able to provide better service or more service to the Postal Service?

General POTTER. I am very grateful to Amtrak for the help that we received immediately following September 11 because of the fact that we were not able to fly mail. That has been a relationship that has worked for both of us. We have a lot of rail service, particularly on the East Coast and some rail service moving out to the Midwest, Chicago.

We are reevaluating all of our transportation networks as part of that network integration model that I discussed and what we are finding is that there are some redundant services. There is some mail that we are putting on the train where we have a truck that is just as effective. There is some mail that is on trucks that might be better served on a train, and we are looking at the entire network now, not looking at rail independent from highway, independent from air.

So we are in the throes of that analysis and we will see, once that is completed, what role Amtrak will play. There have been times that we have had concerns about service. We share it with Amtrak and we attempt to work through those problems.

I do have a major concern, though, when it comes to Amtrak and that regards the future of Amtrak. I am sure that all users of that service who hear the debate that is going on inside the Beltway know that there has been a budget request that the appropriation has not quite met and that there is a potential loss on service. So certainly we have built contingency plans to address that situation should it occur.

Senator CARPER. The Senate has actually agreed, in our Transportation Appropriations bill as I recall, to fund Amtrak at the \$1.2 billion request from Amtrak. The House, I think, has included in their Transportation Appropriations bill an amount about three-quarters of a billion dollars, which is higher than the current level of appropriation, although not as high as the Senate, and we will simply have to work out our differences.

We have an opportunity in the context of reauthorizing TEA-21 to determine to what extent this country should be putting additional dollars, maybe earmarked sources of funds, into capital investment for Amtrak to upgrade track structure in the Northeast and to help develop high speed rail corridors in other parts of the country.

I am actually encouraged by a poll that was published, I think in the *Washington Post* this summer, where they questioned people around America about their view of the future of passenger rail service, whether we need it or not, and I think about 70 percent of the people who responded felt that we should maintain or increase Federal support for an inter-city passenger rail system. And surprisingly, you would think older guys like me would be interested in supporting passenger rail, maybe people of my parents' generation who rode the trains when they were younger. Actually, there is a lot of support from young people.

At first I could not understand that, Mr. Chairman, but I think what it is is a lot of our young people have had the opportunity to travel abroad and to ride the terrific trains in Asia and Japan and in Europe, to see what passenger rail can be and to know what the potential could be here.

As I came in, Mr. Chairman, I heard Senator Collins' comments and I think there was some discussion on a commission on postal reform. When you and I were in the House of Representatives—and I think Senator Cochran was in the Senate—one of the first things that was on our plate was a report of a blue ribbon commission on Social Security, trying to figure out what to do to save Social Security at the time. I think Alan Greenspan was on the commission; I think Bob Dole was on it and Claude Pepper.

They gave us pretty good recommendations and we acted on them, depoliticized the issue. We acted on them and 20 years later Social Security is still alive and kicking. It is not perfect but we got through that scrape in pretty good shape.

The president, our new president, proposed a commission to change the way we may invest our monies in Social Security to give people some discretion to invest money on their own outside of the Social Security Trust Fund.

The commission, I think, included Daniel Moynihan, former Congressman Tim Penny with whom you and I served, Mr. Chairman. And they made recommendations but the recommendations have been really for naught. There has not been much that has happened as a result.

We have the opportunity here to consider legislation, probably not this year but maybe next year, on a postal reform commission. I think a postal commission can serve a valuable purpose but I would hope that the nature of the commission and the membership of the commission is such that they will not go into it with a predetermined result and that people of different backgrounds, people with different perspectives, will work together to give us a good consensus position and not a pitch that is already telegraphed.

Do you have any views on the facility or helpfulness of a commission or maybe the nature of its membership?

By the way, we voted this week on a commission on the heels of September 11 proposed by Senators Lieberman and McCain and

I think that commission would be appointed partly by the House, partly by the Senate, and partly by the President.

Any thoughts you have on the composition of a commission?

General POTTER. I believe that a commission should be independent, that given the fact that we are talking about the Postal Service, we probably would be best off if we had business people who are not that close to the postal community, who could take a public policy view of the Postal Service, bring business acumen to the table so they can look at opportunities that might be there, so that there is no bias in terms of what might happen.

I do believe our employees need to be represented on a commission.

Senator CARPER. And how might that be?

General POTTER. Not them personally, but their views need to be represented by somebody who is not a member of our unions or perhaps a competitor's unions but another group from labor that could witness, participate and make contributions to the commission.

I also believe that the mandate and the charter for this commission should be broad and that they should be looking at it in perspective of, as I just said, public policy, universal service in light of the challenges that face the Postal Service—competition with the Internet—look to provide services perhaps in a different way than they are currently done. As I stated earlier, the idea of bringing services to people's doors versus having people have to go to a location is something that should be part of the mix of what a commission would look at. And the Commission should be chartered to provide a mechanism to assure universal service to America for many years to come.

Senator CARPER. Thank you for those views.

My time has again expired, Mr. Chairman. Thank you.

Senator AKAKA. Thank you.

I have another question, Postmaster General. I understand that you have been talking with the two organizations that represent postmasters regarding a new procedure for consultations. What is the status of these discussions and how do you see the matter being resolved?

General POTTER. We have been working with the management of the postmaster organizations for the past year and unfortunately, we did get a little distracted last fall with September 11, with anthrax, and they were active participants on our Mail Security Task Force.

Right after that we had a consultation that we just completed that determined their compensation package for 2 years, so our attention was drawn to that. Once that was completed, we engaged in discussions about changes to the process, the consultation process, that we might embark on in future years.

It is a very interesting dynamic in terms of discussing this issue with postmaster organizations because we have two organizations who represent the same people but do not always think alike; there are a lot of postmasters who belong to both organizations. So we are trying to work through the process of how we could change the consultation effort and have those two organizations participate, given the fact that they may have diverging views but they rep-

resent the same people. So it is a little delicate but we are working through it.

Senator AKAKA. Thank you for your response. Senator Cochran.

Senator COCHRAN. Mr. Chairman, I have no further questions, either. I think General Potter has done an excellent job answering our questions and talking about the Postal Service challenges and plans for the future.

Senator AKAKA. Thank you very much. Any further statements?

Senator CARPER. I have just a few more questions if I could, Mr. Chairman.

Senator AKAKA. All right.

Senator CARPER. A congressman from, I think, New York, Congressman McHugh, has been working on reform legislation, toiling in the vineyards for a long time, and I give him credit for trying to figure out the right thing to do and to do it and there is, I think, some likelihood that we will consider in the House and maybe in the Senate next year reform legislation. I will just give you a couple of examples of things that I hope we could address.

One of those is the issue of retained earnings. Most companies who make a profit retain earnings and they use that for—in some cases they pay dividends to their shareholders. You do not have shareholders but you do have an obligation to the Federal Government to repay and I am pleased at the prospect of your being able to pay that down. But I would like for us to be able to examine whether or not you should be able to retain a portion of your earnings from year to year when you are in a profitable situation.

A lot of companies, when they are figuring out how to price their product or their service, they adjust their prices to what the market will bear. When the demand is strong they may move the price up a little bit; when demand is weak, they may lower their prices. And we have seen with the auto companies the zero percent financing and what that has done in order to spur the purchase of cars, trucks and vans in this country over the last year.

Those are just some of the things. I would like for us maybe to consider this model of what changes, if any, should be made with respect to the Postal Rate Commission, although I am encouraged by the kind of relationship that you described earlier.

I am tempted to ask you what you would have us to consider as we move toward trying to shape some legislation in the next Congress on postal reform. Rather than do that here, though, I think what I will do is just say put it on your radar screen as something we would like to talk with you about and with maybe the Board of Governors and others who represent your employees.

Who chairs your Board of Governors these days?

General POTTER. The chairman is Robert Rider.

Senator CARPER. That sounds familiar. Where is he from?

General POTTER. Delaware.

Senator CARPER. How is he doing?

General POTTER. He's doing great. He hired me. He is doing a great job. [Laughter.]

Senator CARPER. And indirectly, he sort of hired me, too, with about 300,000 other people who voted.

Both the Chairman and Senator Cochran asked a bit about the closure of underutilized facilities. When we were in the House, Mr.

Chairman, I think we had our first round of base closing commissions and we will probably see another one of those in a year or two. I do not recall ever in the time we debated those issues when we were in the House or in the Senate when anyone came to the House floor or the Senate floor and said, "Boy, I wish you would close my base. Sure would like to get rid of my Air Force base or my naval facility or my Army facility." I do not remember anybody ever calling for that.

And by the same token, I do not remember hearing anybody who said, "Please close my post office. We would like to get rid of that baby."

General POTTER. I have not found one yet, either.

Senator CARPER. I have not seen that. But we know that there are bases that ought to be closed and some that have and there are probably some post offices that ought to be closed, as well—maybe not a lot but probably some. And I would just say as you go forward and consider that, what I always find is helpful if you are going to take away a facility or a service that people are used to, replace it with something better. It does not have to be the same facility but provide even better service so that when people come to me or other members of the House and Senate and say, "God, do not let them close my post office," it is really helpful if we can say, "Well, your post office, which is losing X dollars per year, the people who use that service are going to be provided better service in these ways." I would ask that you keep that in mind.

Two more things. One of those is alternative energy. In my State we have learned how to take biodiesel fuel, to mix soybean oil—we have a lot of soybeans in Delaware. We use the oil from the soybeans, we mix it with diesel fuel and now all of our DelDOT vehicles are diesel-powered.

And as we go forward we are grappling with an energy bill in our conference between the House and the Senate today and a part of that is alternative energy, renewable forms of energy, and I do not know to what extent the Postal Service is able to use or uses diesel fuel to power your vehicles. I would just ask that you keep in mind that there is a great interest here in the Senate, not just from Delaware but other places, as well, on the use of biofuels to power particularly diesel-powered vehicles.

General POTTER. We believe that we are a leader when it comes to alternate fuels and we are going to continue to do that. We are very concerned about the environment and so we are a pioneer and we are going to continue to be that way.

Senator CARPER. That is great. In the energy bill that is in the conference there are really three roles that the government is attempting to play to bring about cleaner energy, more efficient energy sources. One of those is R&D investments, early R&D investments through the Federal tax dollars.

The second is to commercialize technologies by using, for example, in vehicles on the military side and our civilian side, to use our purchasing power to commercialize more energy-efficient, cleaner burning vehicles, and you have a great opportunity at the Postal Service to help commercialize those new technologies and we are mindful of that and grateful.

There is a contraption called a Segway which has been developed. I have heard some different uses being proposed for it and I do not know if any of those involve the Postal Service or not. Do they?

General POTTER. We have tests going on around America. We work very closely with Dean Kamen, the founder of Segway and the inventor of Segway, and we are testing them on mail routes across the country. We even have them in the Bronx. We are analyzing the Segway to determine whether or not there are benefits, and we believe there are, to the Postal Service in terms of first for our employees and wear and tear on their legs, as well as the efficiency of delivery of mail. Those tests are under way and I think we are in the second phase of what is a three-phased program to test, thoroughly test, that piece of equipment.

Senator CARPER. Any idea when you will be in a position to say this is good, this is something we would like to use or expand?

General POTTER. As soon as those tests are complete.

Senator CARPER. Next year?

General POTTER. Probably a year from now. We are excited about it. We are making enhancements, and I compliment the folks that work on Segway because as we come up with issues, they find solutions. So it is a good partnership, and we are looking forward to completion of the tests and the analysis of data.

Senator CARPER. Mr. Chairman, my time has again expired. Let me just say thank you for giving me this much opportunity to ask questions. I have had a chance in my first 2 years in the Senate to participate in a lot of hearings and this has actually been one of the more constructive and encouraging hearings and I want to express my thanks to General Potter and those with whom he has worked—employees and your customers and everyone for the encouraging words.

There is obviously more to be done and I like to say that the road to improvement is always under construction and that is probably true in this case, as well.

The last thing I would mention just in closing is grievance procedures—we do not have time to get into it today but I have heard in discussing with our own postal employees in Delaware how grievance procedures just take forever and I would like to have the opportunity maybe to explore how that is changing and what you are doing about that. I know it is a concern.

General POTTER. I would really like to talk to you about that because we have made a lot of progress in grievance procedures. We still have one area that is an area of concern and we are working closely with that union and I hope we can make a breakthrough this year. So I look forward to a conversation on that.

Senator CARPER. Good. Thanks so much. Thank you, Mr. Chairman.

Senator AKAKA. Thank you.

Senator Torricelli has a number of questions for the record and I just want to say that the record will remain open for Senators to submit additional questions until October 4.

Postmaster General, I would like to thank you very much for your testimony and your responses to our questions today. It is clear that the Postal Service is moving forward in its trans-

formation. We must never forget how critical the mail system is to linking our country together and the economic significance of the Nation's \$900 billion mailing industry.

I also would like to thank all of those in the audience who are interested in the well-being of the Postal Service and are working together to meet the challenges ahead. I want to thank the Members of this Subcommittee, too, for their interest in this.

Senator Cochran, would you have any further to add?

Senator COCHRAN. I have nothing further, Mr. Chairman, thank you.

Senator AKAKA. Again I want to say thank you, Postmaster General. This hearing is adjourned.

[Whereupon, at 11:47 a.m., the Subcommittee was adjourned.]

APPENDIX

**TESTIMONY OF
JOHN E. POTTER
POSTMASTER GENERAL
OF THE UNITED STATES OF AMERICA
BEFORE THE
UNITED STATES SENATE
SUBCOMMITTEE ON INTERNATIONAL AFFAIRS,
PROLIFERATION AND FEDERAL SERVICES
OF THE COMMITTEE ON GOVERNMENTAL AFFAIRS**

SEPTEMBER 27, 2002

Good morning, Mr. Chairman and members of the subcommittee. I appreciate this opportunity to meet with you today to report on the progress of the United States Postal Service during the past year.

That progress is a reflection of the efforts not only of Postal Service employees, but of the entire mailing industry – a \$900 billion part of the national economy. Our industry runs the gamut from entrepreneurs operating out of home offices, to some of the largest corporations in America. Over the past year, we've worked to build a foundation of trust and confidence in the nation's mail system. That system has become an increasingly integrated, interdependent national network of 9 million men and women.

We all have a responsibility to strengthen and maintain the public trust and confidence that has been invested in our industry by the American people.

In the past year, we have kept our eye on our core mission: to provide dependable, universal mail service to every American, regardless of where they live, where they do business and regardless of their economic status.

I offer my thanks to this Subcommittee for its commitment to the Postal Service and the people it serves. Your assistance over the last year has contributed to a level of success that, in the first months of the fiscal year, did not seem possible.

It was a year marked by challenges and measured by innovation. We focused on new ways to use the mail and control costs. Working with the Postal Rate Commission and our customers, we brought about an unprecedented, negotiated rate settlement. Together, despite the horror of September 11th and the bioterrorism attacks, we helped keep this nation connected as never before.

Thirteen months ago, I laid out a business plan to refocus the Postal Service on its core business. Six months ago, when we released our Transformation Plan, I also made two pledges. First, I said we would continue our strong focus on improving service performance. Second, I promised we would do our part to

make the Transformation Plan a reality by beginning to make changes that are possible now under the current legislation. In essence, our management team committed to managing the business like never before.

Today, I want to give you a progress report on those commitments.

First, even before the tragic events of September 11th and the anthrax attacks, we foresaw declining mail volumes, even as the universal mail delivery network continued to expand by 1.7 million new deliveries a year.

We knew we had to take some strong steps. We did. They included sweeping organizational changes that started at the top when we reduced the number of officers by 20 percent. We eliminated 800 Headquarters positions. We realigned our field management structure, eliminating 20 percent of our area offices. We reduced administrative staffing by 10 percent – some 2,000 positions in districts and mail processing plants across the country.

After the terrorist attacks, it became apparent that volumes would decline faster than our forecast for 2002. We focused on balancing our use of resources against the lower workload. The employees of the Postal Service realized that we needed to take dramatic steps to manage our finances. The strategy worked.

I am pleased to report that we have pulled \$2.9 billion out of our bottom line this fiscal year by reducing workhours by more than 77 million and reducing career employees through attrition by more than 23,000. Our total complement today is similar to what it was in 1995. Since then, mail volume has risen 21 billion pieces and our delivery network has added 12 million new addresses.

Our operating group destroyed the myth that they couldn't react quickly and decisively in periods of declining mail volume.

Employees and managers rose to the challenge and delivered positive total factor productivity for the year – as well as a 1.9 percent increase in labor productivity.

There were service issues earlier in the year as a result of last fall's attacks on America. Major realignments in our transportation system and major adjustments to our national processing networks were required.

We are all proud of the fact that service performance across the country rebounded in quarter three. By the recently ended fourth quarter, we reached record levels of performance for overnight, 2-day and 3-day First-Class Mail and Priority Mail. Express Mail scores are the highest they've been in four years.

What brought about the quick turnaround? Our employees. They rose to the challenge and focused on service.

We made better use of our transportation partnership with FedEx to move mail by air. And we made adjustments to our processing-time windows in plants throughout America to extend the reach of our surface transportation.

We made better use of our automated equipment – in particular, the use of 530 new automated flats sorting machines. Today, only 10 percent of flats mail in our plants is processed manually.

The Transformation Plan sets aggressive goals for improving service and focusing on our core business: processing and delivering America's mail and doing it affordably with top notch service. We are well on our way to achieving those goals.

Let me assure you, this Transformation Plan is not the "plan du jour." As long as I am Postmaster General, we will use the Plan to advance universal service and America's mail.

We do face a continuing challenge – a communications challenge. It is a challenge to keep our customers, our employees, and members of this Subcommittee and others informed on the progress we are making.

This past year, we have worked with all stakeholders to gain broad understanding of our long-term goals. We leveraged that understanding to open a dialog with our customers that led to an historic rates settlement. We joined with the Postal Rate Commission (PRC) and customer groups to discuss proposals to improve and streamline future ratemaking.

Last week, we filed with the PRC a negotiated service agreement with our largest end-user of First-Class Mail to give them an incentive to grow their business and ours. This week, we filed another proposal with the Rate Commission that would offer small-circulation periodicals a way of achieving work-sharing discounts so common with larger, mass-circulation periodical mailers.

We listened to customers and took advantage of what we can do under the existing laws to offer pricing flexibility to our mailers. We are building a foundation for future growth.

But we must not lose sight of the fact that the Postal Service continues to operate with an outdated business model. The current model needs adjustment.

We worked hard with Congress on a bipartisan reform bill earlier this year. Although it did not move from the House Committee, we are pleased that more and more lawmakers are showing interest in the future of the Postal Service. Our ongoing discussions with the Congress and with the Administration have made us hopeful for the future.

We are working with our unions and management associations to achieve a common understanding that for the Postal Service to move forward, all parties must take an active role.

For instance, this year we reached an historic agreement with the National Association of Letter Carriers to work together to advance Transformation and to explore workplace flexibility.

Looking ahead, there are many things we can and will do in 2003. We are focused on four objectives:

- First, we will continue our commitment to improve service performance. As part of that commitment, we will continue to focus on making improvements to reduce the risk our systems face against another bio-terrorism attack.
- Second, I am committed to exploring, with the Postal Rate Commission, alternatives to the ratemaking process within the current legislation. Those alternatives include additional negotiated service agreements and phased rates.
- Third, we will use our Transformation strategy to grow our business by enhancing existing products and services -- and expanding access and convenience to postal services.
- Finally, we will continue to manage our finances and reduce costs. Fiscal Year 2003 will be the second year in our five-year Transformation commitment to take \$5 billion out of our costs by 2006.

Last year this Subcommittee raised concern about postal debt and asked us to put together a plan for debt reduction. We shared those concerns and focused on finances. We went into FY 2002 projecting a \$1.35 billion negative net income. We also forecast that we would raise our debt by \$1.6 billion. However, we faced other challenges -- a declining economy, September 11th, and the anthrax attacks.

As a result, we renewed emphases on managing our finances. For instance, we took dramatic steps to reduce expenditures, including a freeze on facility construction. Those and other efforts mean our projected negative net income will be less than \$1 billion. This also means that our debt will increase by less than \$500 million.

Looking to FY 2003, our efforts will result in a positive net income. These projections reinforce the pledge I made six months ago that there will be no

general rate increase until 2004. This positive net income also means we will be able to reduce our debt by almost \$1 billion at the end of Fiscal Year 2003.

My expectations are high for the Postal Service, for the nation's economy, and for the entire mailing industry over the next couple of years.

Keeping our rates affordable and improving service are at the heart of the Transformation Plan. The need to execute the entire Transformation Plan remains as critical today as it was 12 months ago when we faced dire circumstances.

I want to thank everyone – our customers, our postmasters, managers, clerks, letter carriers, mail handlers, our unions and management associations – and the members of the Subcommittee – all who helped us keep our commitment to provide universal service to the American people this past year. Together, we have accomplished a great deal. We've begun to chart the course for the future of the United States Postal Service and the mailing industry.

Before I close, it is imperative that I ask your assistance in one key area. As I mentioned earlier, the Postal Service will continue its focus on reducing risk from any future bioterrorist attack. We have submitted a comprehensive Emergency Preparedness Plan to help us identify the long-term needs to safeguard our mail processing systems, our employees and our customers.

The President and Congress came to our aid earlier this year and appropriated \$750 million for costs related to the anthrax attacks to help reduce the risk to our national mail system from biohazardous materials. We are grateful for this assistance in helping to reduce the risk to the mail.

But we continue to deal with some sensitive issues that require your assistance. To that end, we are considering the purchase of bio-detection and vacuuming/filtration equipment for use at some 280 of our mail processing facilities, using the funds generously appropriated earlier this year.

To facilitate the procurement of this equipment, we support and ask for your support of Senator John Warner's amendment to HR 5005, the Homeland Security Bill. This amendment would include the Postal Service among those agencies, such as the Department of Health and Human Services and the Department of Transportation, who are engaged in procuring the means to reduce biohazardous risks. We believe this is the right thing to do.

I thank you for your support and for helping us stay the course during the last year. And I look forward to our continuing work in the years ahead.

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Testimony for the Record

Statement of
Karla W. Corcoran, Inspector General
United States Postal Service
Before the
Subcommittee on International Security, Proliferation
and Federal Services
of the Senate Committee on Governmental Affairs
September 27, 2002

Chairman Akaka and Members of the Subcommittee, on behalf of the Office of Inspector General (OIG), United States Postal Service, I am pleased to submit this written statement. The Postal Service provides a basic and fundamental service to the American public. It entered the 21st century facing challenges posed by new technology and a changing business world, which threatened its very existence and relevance. To address these challenges and its continued viability, the Postal Service developed a Transformation Plan to provide a clear vision for its future. Notwithstanding postal transformation, the OIG stands ready to assist the Postal Service in its efforts to improve public accountability. Specifically, our testimony will discuss the areas of strategic vision, financial management, contracting, core business operations, technology, labor management, oversight of the Inspection Service, and terrorism response. In addition, this testimony discusses the challenges the OIG faces in performing its mission to identify fraud, waste, abuse, and mismanagement in postal operations.

This agency was created as the first independent OIG for the Postal Service by Congress in September 1996 and has grown from 1 to 725 employees. As you know, we have a statutory mission to conduct independent audits, reviews, and

investigations of postal programs and operations, including the Inspection Service. Since our inception, we have identified \$2 billion in potential monetary benefits. However, we still have much work to do to convince postal management and stakeholders of the value of an independent inspector general.

Strategic Vision

The Postal Service is a governmental entity that is required to act in a businesslike manner. While fulfilling its public role of providing universal service, it also must compete with private industry and foreign posts. Being a governmental entity, the Postal Service must be accountable to the public, who fund the Postal Service through the purchase of products and services.

To survive, the Postal Service needs to articulate how it will balance providing public service with commercial enterprise in implementing strategies to meet future service and delivery challenges. This objective cannot be achieved without continuity of vision. However, in the past five years three different Postmasters General have introduced their own distinct vision of the Postal Service's future, and implemented operational changes consistent with their vision, which affected the costs and revenues of the Postal Service. The Postal Service needs a clearly defined, long-term strategy to achieve an appropriate balance between public service and commercial enterprise that transcends short-term changes in senior management.

The General Accounting Office placed the Postal Service on its "High Risk List" in 2001. The Postal Service recently articulated its strategy to address the concerns raised by Congress, the General Accounting Office, and others in its Transformation Plan. The Plan is a good starting point and provides information about the challenges the Postal Service faces, identifies numerous short-term actions to take under its existing authority, and outlines long-term strategies that

would require congressional action. However, as has been identified by numerous sources, the Plan does not define key terms, including universal service. Without a better understanding of these key terms, it will be very difficult to implement the Plan. The Plan also relies on congressional action, which, if not forthcoming, will limit its effectiveness. Further, we noted the Postal Service does not have an overall implementation plan, including prioritization and resource allocation.

Financial Management

Unlike most federal agencies, the Postal Service does not rely on appropriations but instead funds its activities through revenue generation. The Comptroller General recently noted that the Postal Service must provide the public with increased visibility and transparency in its financial operations to assure the public that it is providing the best possible service at the lowest cost.

The Postal Service reported billions of dollars in losses over the past years in its financial statements despite recent rate increases, employee reductions, and a freeze on capital expenditures. In addition, Postal Service workers' compensation costs are increasing at a staggering rate, totaling over \$800 million this year, and the General Accounting Office recently questioned how the Postal Service would disclose to the public almost \$100 billion in future employee retirement and post-retirement health benefit obligations. The Postal Service needs to effectively protect revenues; manage costs and increase productivity in order to improve its financial condition; and provide the users of its financial reports with the necessary information to make informed decisions. The following examples illustrate some of the financial management areas we have identified that require attention.

- Our review of the Postal Service accounting system found that it does not provide program managers the means to effectively track financial obligations, and recommended that the Postal Service improve its accounting system. In one review, Postal Service program managers expressed concerns regarding the absence of complete financial information needed to develop, justify, and defend program budgets. We also found that several managers maintained their own informal checkbook systems to track outstanding obligations for products and services that had been received but not yet paid.
- During our ongoing review of productivity, we concluded that the Postal Service has made tremendous strides over the past two years. We noted that an additional \$2 billion in cost savings could have been realized since 1990, primarily by reducing work hours. The Postal Service's investment in technology resulted in about \$3 billion in cost savings during this same period, but it has been unable to achieve expected returns on these investments through reduced labor costs, in part because of the terms of national union agreements that prevent it from reducing staff.
- The Postal Service did not have the information needed to track the financial performance of over 1,400 postal retail stores. We concluded that postal management will be unable to determine the profitability of individual stores until it implements methods to track cost and revenue.

Because of the significant rise in the Postal Service's costs relating to workers' compensation expenses, we are undertaking a multi-part initiative to address fraud, waste, and abuse in this program. We believe that by expanding our work in this area, the Postal Service will realize reductions in these costs, which have increased over 40 percent during the last three years. These costs include the payment of benefits to postal workers who are injured on the job, as well as

medical provider claims for treatment of injuries. While all federal agencies have experienced a general rise in workers' compensation costs, the Postal Service's increase is greater than the overall federal trend. For fiscal year 2002, the Postal Service has incurred over \$800 million in workers' compensation expenses. Reducing these costs can have a major impact on improving the overall cost of postal operations.

The Postmaster General has agreed that the individual employee workers' compensation fraud investigations will be transferred from the Inspection Service to the OIG. This transfer will start with the Capital Metro area during 2003. We believe that having responsibility for employee workers' compensation fraud, as well as audits and medical provider fraud in one agency, will increase the Postal Service's ability to respond to and reduce costs in the workers' compensation area, and result in program improvements both within the Postal Service and the Department of Labor.

We are encouraged by the Postal Service's recent efforts to minimize its losses and reduce its need for additional borrowing as it approaches the statutory debt ceiling. The Postal Service has also recognized the need to improve its financial reporting systems. Projects initiated by the Postal Service include replacing the current general ledger system, implementing a monthly reporting cycle, realigning its fiscal year with the government fiscal year, and consolidating common accounting services. The OIG supports these efforts to improve financial management.

Contracting

The Postal Service is accountable to the public for ensuring that it purchases high quality products and services for the lowest possible prices. The OIG has also sought to better protect the interest of the Postal Service by promoting

changes to its procurement policies and procedures. As one of the largest contracting organizations in the federal government, administering over \$18 billion a year in contracts for goods and services, the Postal Service must be careful that efficiency improvements in its contracting practices do not unduly increase its financial risk and exposure to fraud. Unlike most other federal agencies, the Postal Service is not subject to the Federal Acquisition Regulations. While the OIG does not believe that the Postal Service should be subject to these regulations, we do believe there are other best practices from this and other sources that could better protect its interests.

Over nine months ago, we proposed revisions to the Postal Service's Purchasing Manual and requested that they be addressed as part of the manual's re-issuance. These revisions included strengthening the examination of records clause, requiring certain contractors to have an approved accounting system, and incorporating a computer security standard provision. In addition, in our testimony a year ago, we stated that the Postal Service was the only major federal procurement agency that still does not honor debarments by other federal agencies. As a result, contractors who have been convicted of defrauding other federal agencies, and have been debarred from contracting with those agencies, are free to contract with the Postal Service. Furthermore, the Postal Service requires a higher standard of evidence than is required anywhere else in the federal government to debar a contractor for fraud. We believe this standard is unnecessary and inhibits the Postal Service from protecting itself from fraudulent contractors. As recently as September 16, 2002, the Postmaster General indicated the Postal Service did not intend to follow any of these recommendations.

The OIG continues to reach out to contracting officials throughout the Postal Service with fraud awareness and prevention messages. We believe the need for increased fraud awareness and improved contracting procedures will help to

prevent the Postal Service from being the victim of contract fraud schemes. The following examples illustrate some of the types of contracting issues we have audited and frauds we have investigated:

- The OIG reviewed Postal Service's use of contracts that are used in times of an emergency or critical need and do not have all terms defined. We found these contracts did not have adequate oversight and increased the risk for the Postal Service to be overcharged. We recommended that the Postal Service increase oversight of these contracts and clarify the contract requirements as soon as possible.
- We have identified over \$462 million in questioned and unsupported contract costs out of \$3 billion in contracts over the past three years. These have included numerous contractors who do not have adequate cost accounting and billing systems to support charges to the Postal Service. For example, we questioned over \$150 million of charges for one major contractor, who had almost \$402 million in contracts, because of major accounting and estimating system deficiencies.
- Based upon information from the OIG, the Postal Service evacuated a newly built mail processing center because of identified safety hazards. Postal operations were temporarily disrupted while repairs were made, impacting service. The OIG investigation determined that a contractor solicited bribes to certify defective construction work at this facility. Through OIG efforts, this unscrupulous contractor was indicted and prosecution is pending.
- A major environmental services company recently pled guilty to performing false tests at postal and other government facilities around the country. Company employees committed a number of improper and fraudulent

practices when testing underground storage tanks in postal and other federal facilities. As part of a plea agreement involving 89 sites, of which 33 were postal facilities, the company will pay a \$1 million criminal fine and restitution of nearly \$1.3 million. The company also agreed to take corrective actions to prevent recurrence of the improper testing.

- OIG investigators worked with the Postal Service law department to reach an agreement with a major technology firm to settle false claims for over billing related to work performed during Year 2000 (Y2K) preparations. The company agreed to pay the Postal Service over \$800,000. The company was one of several contractors hired by the Postal Service to ensure that Postal Service systems would function properly for the Y2K deadline. The charges arose from whistleblower allegations that the company had billed the Postal Service for contract work performed by unqualified employees or work not performed under the Y2K Postal Service contract requirements.

We are encouraged by the Postal Service's supply chain management initiative that will leverage the Postal Service's purchasing power by centralizing and consolidating purchases. If implemented properly, it can result in more favorable pricing to the Postal Service. In addition, the Postal Service has initiated an internal website to refer contract audit issues to the OIG.

Core Business Operations

Amidst the debate over the future of the Postal Service and its efforts to leverage new technologies and approaches to improve operations, it must continue to be accountable for its primary objective - delivering the mail. A significant disruption of these core operations would be readily noticeable and would further jeopardize the public's confidence in the Postal Service's ability to compete in a changing marketplace and overall financial condition of the Postal Service. The

following examples illustrate the core business work, which includes accepting, processing, transporting, and delivering the mail, as well as marketing postal products and services.

- An OIG audit of the Postal Service's leased fleet of about 8,700 trailers projected that more than 25 percent of the leased trailers did not meet safety standards, \$5 million in leased trailer inventory could not be accounted for, and damage claims were paid to contractors without determining fault or verifying the cost of the repairs. The Postal Service leases trailers to provide operating flexibility in transporting the mail.
- In an ongoing review, we identified about \$29 million of excess spare parts for mail processing equipment. The excess inventory resulted from purchasing parts above actual demands and maintaining stock levels higher than needed.
- An OIG audit of the automated mail handling system disclosed that projected work hour savings would not be realized, and the robotic system was deployed, although it has consistently not met anticipated performance criteria. We concluded that the return on investment was overstated because \$4.1 million in costs were not included in the cost-benefit analysis.

The Postal Service takes continuous action to improve core business operations such as its recent highway network system and carrier productivity initiatives that are designed to reduce operating costs and improve customer service.

Technology

Investments in technology require strong control and accountability because of their high costs and potential impact on service. It is not unusual for these investments to cost hundreds of millions of dollars, and if the technology fails to work properly, mail delivery may be slowed and privacy information compromised. OIG reviews within the area of technology have covered the development of new systems, information systems, and eCommerce initiatives, some of which are listed below.

- During the past year, OIG has issued 15 reports on telecommunications security at six locations. These reports identified significant vulnerabilities in the security of the computer equipment that the Postal Service depends upon for the efficient performance of its nationwide area network. We worked closely with the Postal Service as they took action to ensure these vulnerabilities did not result in a loss of confidentiality, integrity, and availability of vital financial and operational systems.
- Our review of six systems under development disclosed that planning could be improved, requirements better defined, more thorough testing performed, and a standard methodology used. Changes, made while a system is under development, are 50 to 100 times less costly than after a system is operational. As a result of our reviews, Postal Service management implemented a standard methodology for system development efforts.
- Our reviews of eBusiness agreements found that in some cases the agreements did not contain adequate security provisions. In addition, procedures to protect individual privacy information were inadequate. Postal management is proactively working to correct these deficiencies by

appointing a chief privacy officer, increasing focus on security, and updating policies in these areas.

- Our review questioned the need for five concurrent projects with similar goals and objectives. All five projects, with a total cost of over \$22 million to date, were cancelled after the Postal Service decided not to pursue any of these initiatives.
- In another review, a retail website was established without regard to the full cost of development and operation. We projected that the website's costs would exceed revenues by more than \$5 million over a 10-year life. To respond to our concerns, the Postal Service combined this website into an existing website, which decreased the cost of the project.

The Postal Service realizes the need to improve the quantity and quality of information available to its customers. The Information Platform program is a series of initiatives with the goal of improving customer satisfaction and Postal Service operations. Our review of several of the individual initiatives determined that they have the potential to be successful.

Labor-Management

The Postal Service is accountable for ensuring the safety and well-being of more than 800,000 full- and part-time employees, while also maintaining a productive and cost-effective workplace. Labor-management problems cost the Postal Service millions of dollars each year, adversely affect employee morale, decrease quality of service, and may ultimately result in higher rates. The following examples illustrate our work in this area.

- Our current work estimates the Postal Service has incurred about \$500 million in the past four years for labor-management problems. We also estimate this amount could potentially escalate to over \$1.1 billion by the end of fiscal year 2003. Much of this cost is directly related to the thousands of grievances filed annually and the missed opportunities to prevent and/or resolve grievances at the lowest possible level. Although several independent organizations, including the OIG, have made numerous recommendations on how to improve relations between the Postal Service and its unions, many of them were not fully implemented.
- Despite our efforts to assist the Postal Service in extending reprisal protection afforded to other federal employees under the Whistleblower Protection Act, employees are still not afforded this protection. The Postal Service agreed to extend protection in May 2001; however, the regulations have not been finalized. We continue to work with the Postal Service to prevent reprisal against postal employees who report fraud, waste, abuse, and mismanagement to the OIG; however, if no action is forthcoming by the Postal Service, legislation may be necessary to secure this protection for Postal Service employees.
- We concluded that the Postal Service's pay-for-performance program contributed to significant improvements in mail delivery service and employee safety, but did not result in improved workplace relations or financial performance. Based, in part, on our work, the Postal Service discontinued the program and agreed to incorporate accountability for those areas in a new program it plan to establish.
- In a recent audit of the Postal Service's corporate succession planning process we found its plan for filling vacant Postal Career Executive Service positions included many features that we identified as best practices for

successful organizations. The Postal Service had also implemented diversity programs into its planning process, resulting in a slight increase of some diversity statistics. While there were some areas in need of improvement, overall we believe the Postal Service has done a good job in this area.

We are encouraged that the Postmaster General has identified the development of future leaders as one of the Postal Service's performance strategies in its Transformation Plan. This strategy includes the continued use of executive development programs, accountability for successor development, and a measurement system to evaluate the effectiveness of succession planning.

Oversight of Inspection Service

Unlike other federal law enforcement agencies that operate with appropriated funds, the Postal Inspection Service operates with postal revenues. The Postal Service needs to be accountable to postal ratepayers and customers for how these postal revenues are used. The OIG has express statutory responsibility to oversee the Inspection Service. Following are examples of some of our oversight activities.

- An OIG investigation revealed that the Inspection Service granted a sensitive clearance to an employee of a postal information technology contractor, despite having learned from the Office of Personnel Management that the contractor had a prior federal felony conviction for unlawful receipt of pornographic images of children.
- The OIG found the Inspection Service granted an interim clearance that allowed a contractor to begin working for the Postal Service even though the contractor admitted to having been fired from two previous jobs. The

contract employee was subsequently caught hacking into other computer systems, using postal computers.

- A review of Inspection Service investigative activity directed at fraud against other federal agencies revealed that these investigations primarily benefited other agencies with little benefit to the Postal Service. Only \$2.9 million of the \$491 million in reported fines and restitutions was actually owed to the Postal Service.
- A recent review of the health examination program identified the Inspection Service had not adequately validated physical requirements or finalized medical standards for inspector positions. Management also did not ensure all postal inspectors obtained or completed periodic health examinations as required. As a result, management may have placed postal inspectors and others who are dependent upon their performance at risk. However, we also found that management did not use the health examination program as a punitive measure.

Despite our mandate to provide oversight to the Inspection Service, the OIG, at times, has faced challenges in exercising its oversight responsibility, which include questioning of the OIG's authority and refusing unrestricted access to personnel and information. We have recently reorganized our Inspection Service oversight program with the goal to improve our effectiveness. We intend to have our efforts more closely reflect the approach of other inspectors general, e.g., Department of Justice and Treasury Inspector General for Tax Administration, which have oversight responsibility over major federal law enforcement organizations. The OIG will continue to work with the Inspection Service and senior postal management to resolve these challenges. We look forward to establishing an environment of cooperation with the new Chief Postal Inspector.

Terrorism Response

The American public expects the Postal Service to provide safe mail and a safe work environment for its employees. Following the discovery of anthrax in the mail, the OIG shifted resources and responded immediately in support of the Postal Service. Our reviews identified opportunities for improvement in the following areas.

- In an examination of contracts for decontamination and detection equipment, we identified contract provisions that deviated from standard contract language or were omitted from 11 contracts, totaling over \$100 million. While we understand the need to expedite purchases to protect the mail, employees, and the public from the anthrax threat, we believe the Postal Service was unnecessarily exposed to increased financial risk because it did not properly document important contract decisions, including determinations of price reasonableness.
- We found that hazardous mail transportation and facility leasing requirements were not well understood at the area and local level, resulting in improper transportation of potentially contaminated mail and more than \$600,000 in wasted funds for leasing facilities which, ultimately, could not be used for decontamination purposes.
- We found that management allowed a contractor to both decontaminate a postal facility and then verify that the work was done properly. Because of the sensitivity of this situation, good internal controls provide that the two functions be conducted by separate contractors to provide reasonable assurance that the decontamination process was effective.

- We identified three organizations with alleged ties to terrorist activities who were mailing at nonprofit rates and had funds in bulk mail accounts. We referred the information to Postal Service officials, including the Inspection Service, as well as the Federal Bureau of Investigation Counter-Terrorism Unit. Subsequently, the Postal Service froze the funds and has requested guidance from the Department of the Treasury for a final determination on the disposition of these funds.

In the OIG's anthrax capping report we commended the communication efforts, safety, and self-initiated actions taken by the Postal Service, and concluded that the Postal Service communicated an extensive amount of information on mail handling received from health experts to ensure the safety and health of its employees. The Postmaster General showed extraordinary leadership during this very difficult time.

OIG Challenges

We continue to educate Postal management on our independence and authority. However, management challenges this independence and authority in various ways: by directly attempting to limit our independence, withholding information we request, omitting required statements in contracts, trying to direct our work, and failing to support our role and mission.

When the General Accounting Office sought to change government auditing standards to the detriment of non-presidentially appointed inspectors general, we led the fight to ensure that our independent status and role was maintained. We occasionally have problems obtaining information from postal management that is complete, relevant, and timely. The OIG generally can resolve these issues after bringing them to the attention of senior management, but these situations

create a confrontational environment and unnecessarily delay our work. Senior Postal management needs to do more to keep this from reoccurring.

We have encountered difficulty in obtaining contractor records because some Postal Service contracts either have restrictive language or do not include adequate provisions for access to records. For example, the Postal Service entered into a major agreement that did not have an access to records clause. In another case, the Postal Service agreed to language in a contract that attempted to prohibit disclosure of the company's information to anyone without the contractor's prior consent. These contract clauses are contrary to the OIG's statutory authority to have unrestricted access to all Postal Service records.

Postal managers often do not share our perspective on the role of an OIG and believe that OIG auditors should generally work in the financial management area and not review Postal Service performance, mission and policy areas. For example, when we initiated an audit of the Postal Service sexual harassment prevention program, we met with considerable resistance from management. These officials stated that a review of this nature was not an appropriate undertaking for the OIG and questioned what value we could add. This type of resistance from postal management compounds our difficulty in obtaining the necessary cooperation from other personnel to effectively evaluate postal programs and operations.

As stated above, leadership in assuring that Postal Service supports the role and authority of the OIG is critical to our effectiveness. In addition to assuring access to records, additional support is needed in the area of management comments to our reports. Some managers agree with our recommendations but try to discredit the overall report by disputing the facts contained in the report, even though the facts are supported by evidence. Postal Service management recently established a postal unit for facilitating the audit process, which is a step in the

right direction but still needs improvement. We believe it is incumbent upon the Governors, Postmaster General, and other senior postal officials to provide leadership in support of the OIG's statutory mission, role and authority.

In addition, the OIG is facing the following challenges that impact our continued relevance to Congress and the Postal Service:

- The Postal Service is the only major federal agency where the Inspector General serves a statutory term. The Inspector General's seven-year term will end in January 2004, and the Governors will need to identify a successor. Because the Inspector General is not appointed by the President and confirmed by the Senate, Congressional oversight and awareness of the hiring of the next Inspector General may be limited. In addition, unlike other government officials such as the Comptroller General and the Director of the Federal Bureau of Investigation who serve fixed terms, there are no provisions in the law to protect the Inspector General from forced retirement at a reduced annuity.

The Office of Personnel Management has provisions for government senior executives that when not recertified (similar to the term limit for Postal Service Inspector General), the executive may retire without taking a reduced annuity. Without these protections highly qualified career senior executives from other agencies will be deterred from seeking the position if they are not eligible for full retirement at the end of their term. This may increase the possibility of someone with close ties to Postal management being appointed to the position, which could have an adverse impact on the actual or perceived independence of the OIG.

- The OIG is challenged to continue to attract and retain talented staff. This is particularly crucial now when agencies such as the Transportation

Security Administration are recruiting many of our employees because of their experience and expertise, and have pay and benefits packages superior to the OIG. The OIG continues to aggressively hire experienced staff as well as train entry-level professionals needed to provide quality audit and investigative services to its stakeholders.

Conclusion

The OIG believes Congress needs to help the Postal Service define its role for the future so it can fulfill the needs of its ratepayers, employees, and the American public. The Postal Service cannot renew itself without congressional oversight and attention, as well as a public debate about the continued relevance of the Postal Service. During the public debate over its future, the Postal Service must remain strong enough to continue its mission. Regardless of the outcome of this debate, the OIG will continue to provide independent assessments of ways to improve the Postal Service's public accountability, services, and operations.

We would like to thank you for the opportunity to provide this written statement.

GOVERNMENTAL AFFAIRS SUBCOMMITTEE
ON INTERNATIONAL SECURITY, PROLIFERATION
AND FEDERAL SERVICES HEARING
TO RECEIVE THE POSTMASTER GENERAL'S
ANNUAL REPORT TO THE SENATE
SEPTEMBER 27, 2002

QUESTIONS FOR THE HONORABLE JOHN POTTER
FROM CHAIRMAN DANIEL K. AKAKA

1. What legislative changes do you believe are needed to carry out the Postal Service's short-term actions and long-term transformation strategies, and would you prioritize your legislative needs, beginning with the most pressing?

Successful transformation of the Postal Service depends, in part, on adoption of moderate regulatory and legislative reforms. The Postal Service believes that transformation requires near- and long-term actions. Near-term strategies include those steps we are taking now to improve value to our customers, enhance operational efficiency, and foster a more performance-driven culture. These strategies require only modest legislative and regulatory changes. Legislative reform for the longer term is needed to define a legal framework for the postal system in the 21st century that remains consistent with the shared vision of the United States as a place where all citizens, in every part of the country, can participate equally and easily in the life of the nation.

Our most critical legislative need, at this time, is statutory change to our Civil Service Retirement System (CSRS) payment schedule. If Congress approves statutory change to the payment schedule, it would add \$2.9 billion to our bottom line in FY 2003 and another \$2.6 billion in FY 2004.

At GAO's request, OPM actuaries analyzed our financial records and discovered that the Postal Service has nearly fully funded its CSRS obligations and will exceed that obligation on its current payment schedule. OMB and the Department of Treasury have validated OPM's analysis.

Prior to review and based on current statutes, the Postal Service maintains a \$32 billion deferred liability for its CSRS obligation. The new analysis shows the actual funding gap is only \$5 billion.

With this change, rates could remain stable until at least 2006 and debt reduced by more than \$3 billion in FY 2003, compared to the planned debt reduction of \$800 million.

There would be no changes to benefits or employee contributions. There would be no harm to current or future retirees. Without prompt statutory change, our customers would overpay retirement costs, and we would be forced to file a rate case next spring in order to implement a rate increase in 2004. Members of the Mailing Industry CEO Council, whose members include the Chief Executive Officers of a number of major mailers across the country, have sent a letter to President Bush in support of legislation that would let the Postal Service significantly lower its contributions to the Civil Service Retirement System. Failure to pass this legislation could have far reaching economic effects on the \$900 billion mailing industry.

In terms of legislative postal reform, the Postal Service seeks greater pricing and purchasing flexibility, labor and employment reforms.

Historically, Congress has provided a legal monopoly over the delivery of letters to provide financial support for universal service to all areas of the United States. We believe that universal service at affordable rates should be maintained.

There are potentially many alternative ways of serving all of America. The combination of days of delivery, method of delivery, service commitments, access points, and other elements of providing universal service may need to evolve in any number of ways.

The Postal Service recognizes that the way in which postal services are provided in the future remains an important matter of public policy on which the entire postal community should be heard.

Within the framework of the current rate-making process, the Postal Service has requested several reforms to respond to customer pricing needs and restore postal finances to a more sound footing. We have obtained approval for negotiated service agreements and will pursue other targeted pricing initiatives, mail classifications reforms, phased rates, and inclusion of costs in the revenue requirement to finance the expansion of the delivery network on a current basis. The Postal Service believes that some of these reforms can be implemented administratively with the assistance of the Postal Rate Commission (PRC). If, in the course of these efforts, we identify obstacles to adequate pricing flexibility, we will ask Congress to enact legislation to remove those hurdles.

We are determined to do everything we can under current law to keep improving. But we have also concluded that, after 32 years, the Postal Service needs legislative changes to support a more modern business model suitable for the dynamic commercial world we face today. We welcome the assistance of Congress, our customers, our labor and management associations, and other stakeholders in this endeavor.

We also look forward to the recommendations of the Presidential Commission, which President Bush has recently established. This action is consistent with—and complementary to—the Postal Service's *Transformation Plan*. Our Plan defines the actions and strategies we currently are following to protect affordable, universal service for everyone in America. We look forward to working with the Commission as it develops recommendations for the future.

2. For the past two years, the Postal Service has frozen capital spending. Would you share with us the impact this freeze has had on postal operations, and how the Service will deal with its growing backlog of needed capital investments?

The hold placed on most capital investments in April 2001 continues. However, items meeting the exception criteria of life, safety, and legal obligations or investments that are expected to produce a high return on investment (ROI) are being approved. Our commitment plan for FY 2003, at \$2.5 billion, is \$1 billion greater than commitments made in FY 2002. In FY 2002, the Postal Service committed \$244.2 million for investments in support of its facility program and has planned commitments for \$755 million in FY 2003. Additionally, repair and alteration expenses valued at \$165.9 million were incurred in FY 2002.

The Postal Service has had an active, well-planned facility program; therefore, the freeze has been manageable thus far. For FY 2003, the facility investment criteria have been expanded to address high growth areas, facility obsolescence, and necessary maintenance of our real property assets. With continued focus on capital investments in automation/mechanization equipment (\$738 million has been included for these in the FY 2003 plan), operational impacts have been minimized.

The Postal Service is evaluating its entire network, including its current infrastructure. Therefore, Postal Service plans beyond FY 2003 also will assume criteria for facility-related investments that concentrate on crucial infrastructure replacements, particularly in high-growth areas. Future projects will be reviewed on a case-by-case basis.

3. The Postal Service has discontinued its EVA performance-based pay system for supervisors, managers, and other executives. What will replace this system, and do you expect to make performance-based payments this year? If so, on what basis will the payments be calculated?

For FY 2002 no performance-based payments were made to supervisors, managers, or other executives. A new executive incentive plan has been approved for 750 executives and officers for FY 2003. Supervisors, postmasters and others represented by the three postal management associations will be considered for participation in FY 2004, following statutory pay consultations.

The new executive incentive plan contains pre-established goals covering a balanced scorecard of performance measures (see table below). Various performance-levels have been defined for each executive to encourage continuous efforts at break-through performance. Future incentive payments will be based on customer service, employee commitment, productivity, and revenue improvements. The funding pool will follow a budget approach that uses a percentage of all career executive and officer salaries based on performance achieved. This funding approach is similar to the approach of the federal sector for performance award bonuses for Senior Executive Service employees.

FY 2003 Goals, Sub Goals, and Indicators

	Goal	Sub Goal	Indicator
Voice of Customer	Growth	Timeliness and Consistency	Priority Mail On Time – Surface Network
			Priority Mail On Time – Air Network
			Express Mail On Time
			First-Class Mail On Time – Overnight Commitment
			First-Class Mail On Time – 2 Day Commitment
			First-Class Mail On Time – 3 Day Commitment
Voice of Employee	Motivated, Productive and Inclusive Workforce	Minimize Impact from Accidents and Absences	OSHA Illness/Injury Rate
		Employee Committed to USPS Success	VOE Survey
Voice of Business	Affordability	Improve Productivity To Control Costs and Improve Contribution Levels and Grow the Business	National Total Revenue
			Total Factor Productivity

4. Concerns have been raised about the Postal Service awarding large, multi-year sole source contracts, such as those awarded to FedEx and GoodYear. Why is the Postal Service increasing its reliance on sole source contracting rather than providing opportunities for open competition?

The Postal Service purchases noncompetitively when doing so makes the best business sense. Purchase teams must justify a proposed noncompetitive purchase, and all noncompetitive purchases valued at more than \$250,000 must be approved by increasingly higher management levels, depending on the dollar value.

Although the percentage of contracts awarded noncompetitively has risen slightly over the past three fiscal years (from 4.3 percent in FY 1999 to 6.2 percent in FY 2001), the percentage of FY 2001 noncompetitive awards compares favorably to those of four Federal agencies whose requirements are similar to those of the Postal Service:

- NASA	- 19.3 percent
- Department of Defense	- 14.4 percent
- Treasury	- 10 percent
- General Services Administration	- 4.3 percent

The contract with Federal Express was awarded noncompetitively after a comprehensive survey of the air freight industry revealed that Federal Express was the only carrier able to meet the Postal Service's requirements. The Postal Service considered a wide variety of important factors in making this decision, including a company's service network, record of service reliability, fleet make-up, maintenance costs, and other factors. The award decision was challenged and upheld in both the Court of Federal Claims and the US Court of Appeals.

The contract with Goodyear was competitively awarded. Prequalification packages were solicited from the major tire companies which had previously sold tires to the Postal Service. After evaluation of the packages, three companies were prequalified. Each company made an offer for the contract. The purchase team determined that Goodyear's proposal offered the best value. Goodyear was also the only offeror that provided the full range of tires required by the Postal Service.

5. One of the initiatives in the Transformation Plan is a private, employee-owned company to investigate equal employment opportunity complaints that was expected to be set up by June 2002. Can you provide us with an update on the status of this initiative, and do you see the potential for this approach in other areas?

Negotiations with the new private company, which will be owned, in part, by former Postal Service employees as an employee stock ownership plan (ESOP)-based company, will commence in December. If the contract is successfully negotiated, the Postal Service will begin to transition its EEO investigations to the new company. It is expected that the final transition would be completed by July 2003.

With respect to the possibility of using the same approach in other areas, the Postal Service is faced with the need to examine all of its administrative functions to determine what internal work is neither required for nor supportive of its core business—the prompt, universal delivery of the mail. If the EEO ESOP initiative is successful, it would make good business sense to look at other areas within the Postal Service that could benefit from a similar approach.

6. Since January 2001, the cost to postal customers using Priority Mail has increased 30.4 percent, with an associated decrease in volume of 22 percent. What actions are being considered to make Priority Mail competitive, especially in areas of service improvements and rate moderation?

The Priority Mail redesign effort has developed a simplified distribution process which encompasses ZIP Codes and shape-based distribution resulting in higher productivity and improved service. Area teams have been assigned to implement Priority Mail standardization across the country, including reducing transportation costs through enhanced shared networks and tracking service performance. Letter carriers are helping to generate Priority Mail leads through a program called Customer Connect, which targets small to mid-sized businesses. The Postal Service also plans to help educate customers and employees on Priority Mail's value added services, such as no residential or rural surcharges, free supplies, and free Saturday delivery.

7. This summer, an article in the International Herald Tribune detailed concerns that parcel mail sent from the United States to Europe may result in unforeseen costs to the recipient. Would you explain how U.S. parcel mail travels through customs in Europe and what costs a recipient should expect? Are these costs explained to postal customers before mailing international packages? Are you reviewing your contract with Consignia and its affiliates, which handles European mail for USPS parcels?

Air Parcels and Global Express Mail (EMS) items mailed to Europe are transported by air to Germany where German Customs inspects each parcel and determines if it is subject to duties and taxes. If the item is not subject to duties and taxes because its value is below a certain threshold, it is transported to the destination city and delivered without any duties, taxes or fees.

assessed. The items that are determined to be of low value represent about 74% of the total volume. If the item is destined for a European Union country and the value of the item is over the threshold of €45 and the item is sent by an individual to an individual, German Customs assess a flat duty and tax rate of 13.5% of the value of the item. If the item is sent by a business or to a non-EU country and the value of the item is more than €22, the parcel is transported to the destination country where that country's Customs authorities assess Customs duties and taxes based upon the package contents. The Customs duties and taxes, plus a current fee of €17 for customs clearance, is collected from the recipient, either at the time of delivery or by billing. The Postal Service is working with Consignia and its affiliates to significantly reduce this administrative fee.

The International Mail Manual explains to customers that Customs duties, taxes and fees may be assessed in the destination country and that they are the responsibility of the recipient (Section 713.45, IMM). This information has been published in the *Postal Bulletin* so that window associates can explain this process to customers. This information has been published on the Postal Service's website and can be found at www.uspsglobal.com. A condensed version of this information has been programmed into point-of-service terminals so that window associates can make retail customers aware of this process. Finally, this process is being explained again to window associates and postmasters in service talks that will be published in the *Postal Bulletin* in November and December as reminders to them during the Christmas mailing season.

We are currently reviewing the agreement with Consignia and are in negotiations to better meet the expectations of our customers.

8. The written testimony submitted by the USPS Inspector General stated that nearly a year ago, the IG proposed revisions to the Postal Service's Purchasing Manual. Ms. Cochran's testimony also notes that the Postal Service is the only major federal procurement agency that does not honor debarments by other federal agencies. Will the Postal Service follow any of these recommendations, and if so, which ones will you follow and which ones will you not follow? Would you please provide the rationale for these actions?

The Inspector General (IG) submitted a number of proposed revisions to the *Postal Service Purchasing Manual* (PM) in December of last year. At that time, some very substantial changes were already well underway to the PM. The IG's proposed changes are being considered for the next revision to the PM. Talks were held in October with the IG's representatives, and we agreed that the proposed changes would be addressed when more background information is provided. The changes will be addressed this fiscal year, and those that are accepted will be included in the next revision to the PM.

We are working with the IG's representatives to determine if the changes are in concert with the Postal Service's purchasing and strategic objectives. Regardless of the outcome of this process, the proposed changes will be considered by the Supply Management Policy Committee, which will then make a recommendation to the Vice President, Supply Management. We will provide the IG with the rationale for each decision.

Regarding the Postal Service's debarment policies and procedures: Pursuant to statute and Executive Order, debarments and suspensions by a procurement activity under the Federal Acquisition Regulation have government-wide effect. The Postal Service is not such a procurement activity, so other government agency debarments do not, as a matter of law, prevent the affected party from contracting with the Postal Service. The reason for a debarment may involve the violation of a law or regulation that does not apply to the Postal Service. In such cases, debarment or suspension of the supplier may not be appropriate. Postal Service policy, however, does require contracting officers to consult the General Services Administration's government-wide list of debarred and suspended suppliers when evaluating the capability of prospective suppliers and to justify any decision to award a contract to a supplier included on the list. In addition, as appropriate, the Postal Service may decide to debar or suspend a supplier based on its debarment or suspension by a government agency. Under this authority, the Postal Service recently took such action against Arthur Andersen and the Enron Corporation following their suspension by GSA. Moreover, while we believe the Postal Service has appropriately addressed the issue of debarment and suspension in every specific case it has reviewed, we are working with the IG's representatives to determine if any meaningful and effective changes should be made in this area.

9. I understand that the Postal Service agreed to extend whistleblower protections to its employees in May 2001. However, the Inspector General advises me that regulations have not been finalized. Why has there been such an untimely delay, and when can we expect to see final regulations that would cover postal employees under the Whistleblower Protection Act?

After an exchange of draft regulations, on Friday, October 11, 2002, a meeting was held between the Inspector General and the General Counsel of the Postal Service regarding the approach that should be taken in the regulations extending existing protections for whistleblowers in the Postal Service. As a result of that meeting, we modified our draft of the regulations and sent the modification to the OIG. This process of developing regulations is ongoing at this time.

However, providing protection to employees who report allegations of fraud, waste, abuse, or mismanagement to the OIG is not new in the Postal Service. Even before the Postal Service had an OIG, we had regulations to ensure that the rights of employees who report allegations of fraud, waste, abuse, or mismanagement are not the subject of any inappropriate actions.

These regulations specifically provide protections for whistleblowers. Section 668.118 of the Employee and Labor Relations Manual states:

"No one may take or fail to take a personnel action as a reprisal for a disclosure of information by an employee or applicant which the employee or applicant reasonably believes evidences:

"a. A violation of any law, rule, or regulation: or

"b. Mismanagement, a gross waste of funds, an abuse of authority, or a substantial and specific danger to public health or safety, if such disclosure is not specifically prohibited by law or if such information is not specifically required by Executive Order to be kept secret in the interest of national defense or the conduct of foreign affairs.

Further, in a March 19, 1998, memorandum to all Postal Service Officers, then Deputy Postmaster General Michael S. Coughlin reaffirmed the following two self-evident statements of principle:

- "1. No retaliatory action is to be taken against any postal employee for alleging to the Office of the Inspector General wrongdoing of any sort within the organization. While this is specifically written into Section 7(c) of the Inspector General Act, I would expand its application to include as well similar disclosures to responsible members of USPS management and the Inspection Service.
- "2. The integrity of the internal review process must not be compromised in any way through the direct involvement in it by a postal official with a self-interest in the outcome of the investigation. This means, among other things, that there will not be a direct reporting relationship between the investigating, proposing and deciding officials responsible for action upon the allegations.

In May of last year, this message was again conveyed to all postal employees in a message from then Postmaster General William J. Henderson. In the May 17, 2001 edition of the *Postal Bulletin*, Mr. Henderson made a commitment to enhance our present whistleblower protections by establishing clear and workable procedures for reporting and resolving complaints by whistleblowers. This statement was the result of a collaboration of representatives of the OIG and Postal Service management.

10. Does the Office of the Inspector General have access to all Postal Service records, and if not, which records are restricted?

The Inspector General Act provides that the Inspector General may obtain access to records needed to perform its functions. To the extent that the United States Postal Service Office of Inspector General (OIG) is internal to the Postal Service, it has some limits under the Privacy Act. The Privacy Act limits access to certain Postal Service systems of records internally to a "need to know" basis. If the OIG is conducting an official audit, investigation, or other official activity, then the Privacy Act would allow access for those purposes. However, no Postal Service employee may have access without the required "need to know." If the OIG were an entity separate from the Postal Service, then the Privacy Act would place greater limits on access to internal Privacy Act protected records. Under the USA PATRIOT Act, the OIG, when it is acting as a law enforcement entity, may also have access to Postal Service records for the purposes of that law.

GOVERNMENTAL AFFAIRS SUBCOMMITTEE
ON INTERNATIONAL SECURITY, PROLIFERATION
AND FEDERAL SERVICES HEARING
TO RECEIVE THE POSTMASTER GENERAL'S
ANNUAL REPORT TO THE SENATE
SEPTEMBER 27, 2002

QUESTIONS FOR THE HONORABLE JOHN POTTER
FROM SENATOR THAD COCHRAN

Transformation

1. How are you monitoring implementation of the plan? Have you established strategies and milestone dates for the various activities included in the Transformation Plan, and if so, could you provide those to us for the record.

The *Transformation Plan* details four categories of strategies that are guiding the transformation of the Postal Service in the near term. These four categories are adding value to products and services (Growth through Value); improving the efficiency of postal operations (Operational Efficiency); transforming the workforce to become more performance-based and accountable (Performance-based Culture), and streamlining the administrative processes that support all postal functions (Enabling).

Within each of these four categories, the Postal Service has identified major strategies and sub-strategies, and within the sub-strategies there are identifiable and specific tasks. From the task level up to the four overarching strategies, all initiatives in the *Transformation Plan* have been assigned both timelines and specific milestones. These timelines and milestones are being tracked on a daily basis with an off-the-shelf commercial software program and are being reviewed on a regular basis by the Postal Service Executive Committee, the senior decision making body of the Postal Service.

2. Give us an overview of the major changes in operations, infrastructure, and workforce that you see will be necessary to carry out the Service's transformation.

In order to address the challenges we face today and to prepare for transformation, we must push business effectiveness and operational efficiency to the limits permitted by current postal laws. Cost containment is the most important customer-focused strategy, especially for large business mailers who rely most heavily on postal infrastructure. In any network business, however, it is difficult to control costs when volume declines while the network itself continues to grow. This is the challenge faced by the Postal Service: increasing costs may have to be spread across a declining volume base. In this difficult environment, we will achieve cost savings by implementing a number of specific measures designed to improve operational efficiency over the next five years.

1. Reduce operating costs by automating the flats mail stream and mail forwarding operations.
2. Continue improving annual productivity through techniques such as benchmarking, standardization of best practices, and complement planning and scheduling.
3. Explore new workshare and mail preparation opportunities to eliminate handlings in the presort-to-delivery supply chain.
4. Develop new methods of reducing the time letter carriers spend in the office, for example, sorting flats into delivery sequence.
5. Reduce transportation costs and improve transportation management by improving network planning, routing, and tracking programs.
6. Redesign the postal logistics network so that the number and location of processing centers, processing strategies for mail, and transportation modes and routes are optimized to meet customer service requirements at minimal total system costs.
7. Revise purchasing regulations to allow for acquisition of goods and services in a manner similar to that followed by businesses.
8. Explore alternative purchasing strategies for automation equipment and information technology to include leases and fee-for-services contracts.
9. Optimize the retail network by lifting the self-imposed moratorium on post office closures and working with the Postal Rate Commission to streamline the process for closing post offices.
10. Pursue regulatory and legislative reform to provide the Postal Service with a definition of universal service that is flexible and pragmatic so that new methods of providing access to service are taken into account, and networks and services are not unreasonably tied to historical conditions.

Some of these changes will impact the postal workforce. We are closely managing employee complement to better position the organization for these changes. Also, the current collective bargaining agreements with our unions provide a degree of flexibility in realigning the workforce to meet most of these necessary adjustments. However, there may be instances where additional latitude will be required. We will honor the terms of our current labor agreements with postal unions that include a no layoff clause, and we will continue to work with the postal unions to accomplish the transformation. As an example, in the current tentative agreement with our largest postal union, we agreed to form a joint workgroup to develop ways to mitigate the effects of any necessary changes to our workforce.

Financial

3. Over this past year, the Service's estimates of its net income for this fiscal year have ranged from \$1.35 billion to \$4.5 billion. Why have these estimates changed so substantially? What is the Service doing to improve financial information available to the public so we can better understand what is happening and why?

Explanation of Estimates

The \$1.35 billion loss referenced above was the Postal Service's approved net income plan developed in July and August of 2001 and approved by the Board of Governors on September 11, 2001. The FY 2002 plan assumed an increase in volume of 2.2 billion pieces; a 3.7% increase in revenue; an increase in expenses of 3.2% with a 1.9% reduction in work hours; and a rate case decision that would be implemented after the fiscal year closed.

Unfortunately, the Postal Service could not predict the enormous challenges that the world would face beginning the very day the FY 2002 plan was approved. The Postal Service was not exempted from these challenges. Reflecting forecasted impacts of the tragic events of September 11 and the ensuing anthrax incidents and their unknown costs, the Postal Service produced a worst case scenario projection of net income that estimated a FY 2002 net loss of \$4.5 billion. This projection was based on the operating results of Quarter 1, FY 2002, in which the Postal Service experienced the greatest quarterly reduction of volume (5.5%) since the Great Depression and a revenue plan under-run of about \$900 million. This revised projection also assumed that the economy would rebound slightly and slowly and that any rate relief would not be forthcoming until the following fiscal year. Additionally, the Postal Service was then in contract negotiations with the National Association of Letter Carriers (NALC) which could have had a major impact on future expenses. On March 13, in testimony before the Committee, the Postmaster General indicated that the projected FY 2002 net loss was anticipated to be in the \$2 to \$3 billion range. At the time of his testimony, recent volume losses and revenue plan under-runs, although still significant, had been less than in the first quarter. The Postmaster General also stated that the revised projected loss could be modified by the impact of three factors: the progress of the economy and mail volume growth; the outcome of the rate process; and the outcome of labor negotiations with the NALC. In fact, the outcome of all three of these factors has positively impacted expenses and revenues of the Postal Service. The economy continued its rebound, albeit in a manner as unremarkable as the recession itself; the unprecedented negotiated rate settlement produced an influx of approximately \$1 billion additional revenue in FY 2002; and a negotiated labor settlement produced known impacts through November 2006. Additionally, the initial impacts of the Postal Service's *Transformation Plan* began taking effect. As a result, in August, the Postal Service announced that the projected net loss would be in the \$1 to \$1.2 billion range. Postal management was challenged for even further belt tightening.

Owing to the effect of all these factors and initiatives, the Postal Service reduced FY 2002 expenses below those of the previous year. This was the first instance of such an expense reduction since Postal Reorganization. The original plan was for a 3.2% increase in expenses in FY 2002.

Despite a significant decline in mail volume during Fiscal Year 2002, we were able to cut a budgeted loss of \$1.35 billion in half to \$676 million, primarily because we have conducted an aggressive expense management program. The Postal Service cut or otherwise avoided \$2.8 billion in costs from the FY 2002 financial plan. Total expenses were held to \$67.4 billion, which was \$185 million below FY 2001 expenses.

We achieved these cost reductions despite the fact that our delivery network grew by 1.77 million addresses. Moreover, during a year in which volume declined by 4.6 billion pieces, we still had a total factor productivity gain of 1.1 percent.

Financial Information

In line with recommendations made by the General Accounting Office to improve stakeholder understanding of its business, the Postal Service intends to add enhanced discussion of performance to its quarterly reports. Beginning in FY 2003, we will provide:

- explanations of material events or transactions and their projected impacts on current operations and financial results;
- on a quarterly basis, expectations for the upcoming quarter; and,

on a quarterly basis, an explanation if the actual results for the prior quarter differ

- significantly from previously discussed expectations.

The Postal Service has reported to the General Accounting Office that it believes these enhancements will assist to provide a better understanding of its financial position. Had these enhancements to regular public financial reporting been in place last year, they would have caused no modification to the substance of Postal Service reports, nor would they have altered the range of projections of Postal Service net income issued over the course of the year. Those varying projections resulted directly from the unprecedented and unpredictable events that occurred after September 11, 2001, and accurately conveyed the Postal Service's assessments of the changing impact of those events upon its operations.

4. The Service projects its long-term debt will rise to \$12 billion by the end of this fiscal year, and it hopes to reduce it by \$800 million by the end of next fiscal year. If volumes do not return as expected, how does the Service plan to address its growing debt problem?

At the end of FY 2001, the debt outstanding with the US Treasury stood at \$11.3 billion. Entering FY 2002, projections for Postal Service borrowing requirements included an increase in debt of \$1.6 billion. Due to some positive developments, however, the Postal Service was able to reduce debt by \$200 million in FY 2002, to \$11.1 billion. This was the first reduction in Postal Service debt since FY97. The factors that brought about this improved borrowing situation included: the early implementation of new postage rates, favorable wage settlements, stringent expense controls, and reduced capital spending.

Progress towards debt reduction should reasonably be measured over time. Building on last year's \$200 million reduction, this year's plan is to reduce debt by \$800 million. That would bring Total Debt Outstanding to \$10.3 billion at the end of FY 2003, which is below the FY 2001 year-end level. Although there are too many uncertainties at this point to project accurately beyond FY 2003, the Postal Service remains committed to reducing debt, as articulated in its *Transformation Plan*.

A new financial analysis of the Postal Service portion of the federal government's retirement fund disclosed that the Postal Service has funded almost in full all future retirement obligations for its employees and retirees enrolled in the Civil Service Retirement System (CSRS). Should the necessary legislation to modify the rate of future Postal Service payments to its CSRS pension fund be enacted, it would increase the amount available for debt reduction in FY 2003 from the planned \$800 million to more than \$3 billion.

5. The Postal Service received \$675 million in appropriated funds this year to respond to the anthrax attacks from last fall. Give us an update on how the Service has spent these funds and how the Service plans to spend additional appropriated funds you believe will be necessary to ensure the safety of the mail system and its customers and employees.

The Postal Service received \$175 million emergency funding from the Administration to respond to the anthrax attacks. The Postal Service allocated these funds for the initial purchase of equipment to sterilize the mail, gloves and masks for employees, environmental testing kits, site clean-up and communication materials for the public and our employees. The Postal Service received \$500 million through the *Department of Defense Emergency Supplemental, Public Law No. 107-117*, which became law on January 10, 2002. Another \$87 million was received through the *Supplemental Act for Further Recovery From and Response To Terrorist Attacks on the United States, Public Law 107-206*, which became law on August 2, 2002.

Regarding the \$587 million in appropriated funds, the Postal Service is working with the leading government agencies to ensure that the funds are spent only after careful review and testing of the associated technologies and appropriate procedures are completed. To date, slightly over \$150 million of the total \$500 million has been committed (contracts issued). Three major efforts outlined in the Emergency Preparedness Plan are still underway: 1. Decontamination of the Brentwood and Trenton Facilities; 2. Implementation of Biological Detection Technology; and 3. Implementation of Filtration on Equipment.

At this time, both the Brentwood and Trenton Facilities are still closed due to the anthrax contamination. The overall scope of this clean up is significantly larger than originally anticipated. After careful planning and review by several scientific, medical, and government agencies, the Environmental Protection Agency (EPA) recommended that the Postal Service use chlorine dioxide gas to fumigate both facilities. An initial three-month delay occurred due to issues surrounding indemnification of the companies performing the decontamination. Then, largely due to the scale of the task, the EPA has required additional testing and verification of the process. Safety remains our paramount concern. However, this has resulted in a considerably higher projection of the final cost. A clean-up of this type has only been done once before. The decontamination of the Hart Senate Office Building required the fumigation of less than 100,000 cubic feet of space at an approximate cost of \$40M. The clean-up at the Washington, DC, facility encompasses nearly 17.5 million cubic feet; and the clean up in Hamilton Township, requires the fumigation of approximately 7 million cubic feet of space. Today, the Postal Service has committed over \$113 M on these efforts and final commitments won't be known until both facilities are completed.

In regard to implementation of a biological detection system, the Postal Service has made significant progress in identifying and validating the technology needed. However, in order to ensure that technology would work in the Postal environment, considerable testing was required. Numerous biohazard detection technologies were tested, and the Postal Service identified one particular technology that will quickly and accurately detect biohazardous material in the mail stream. This technology called Polymerase Chain Reaction (PCR) is able to detect small quantities of DNA with a particular genetic sequence (e.g., anthrax) and is the core of the biohazard detection system (BDS).

The Postal Service is working with the leaders in this field to ensure that all the pertinent tests that need to be done are conducted before a contract is awarded. The testing conducted has been extensive. As a first step, the Postal Service immediately designed and built a simulator of our equipment to test detection equipment. The simulator was then installed in an environmental chamber that has been used to test numerous detection technologies using the Anthrax simulant, B. globigii. The only technology to demonstrate a satisfactory result was the Postal Service's BDS. During four separate and extensive lab tests using actual letter mail, the BDS successfully identified the presence of a biohazard 100% of the time.

In addition, to evaluate and test the equipment in a live-mail Postal Service environment, 12 Biohazard Detection Systems (BDS) were installed and piloted at a Postal facility. While the formal test and evaluation period ended in August 2002, the BDS equipment is still running. In order to continue to move the program, the USPS is now planning to award an interim contract to expand testing at Processing & Distribution Centers in 14 locations. This testing will provide the Postal Service with additional knowledge of performance in various regions. However, before a contract can be awarded for a full production run, the vendors' demand for full indemnification must be addressed.

The other major initiative still underway is implementation of filtration on our processing equipment. As with the other initiatives, the Postal Service is ensuring that the equipment under consideration is carefully tested before a contract is awarded. The Postal Service is working with the National Institute of Occupational Safety and Health and the vendors of the filtration systems to test the different systems' effectiveness. Prototypes of the proposed systems have been installed in Postal facilities and testing has been done on these actual systems. To date, tests have been conducted using smoke and tracer gas to confirm the effectiveness of the airflow. Although this has taken more time than anticipated, the tests on pre-production systems confirmed that the filtration systems provide excellent capture for the target bio-hazards. The tests demonstrate a capture rate that exceeded the 98% targets recommended by NIOSH.

As identified in the Emergency Preparedness plan, the filtration is third on our priority listing for spending the appropriated funding. Because of the additional anticipated cost of the other efforts and the additional requirements of these systems, the overall scope of the filtration equipment that can be afforded under this appropriation has been reduced. The remaining funds after paying for the facility clean-ups and implementation of the bio-detection system will be used to protect our Advanced Facer Cancelers and its loose mail system with filtration equipment. Additional funding will be needed to complete the filtration project.

In summary, the \$587 million appropriation will fund critical elements of our plan needed to enhance the safety of our workers and our customers. The Postal Service is working to ensure that funds are spent only after the technology and procedures have been thoroughly tested. Once these processes are finalized, the Postal Service will be able to ascertain future funding needs.

6. The Service requested about \$900 million in its appropriation requests for fiscal year 2003 for the remaining balance of its revenue forgone. How does the Service intend to spend this money and why are you making this request at this time?

This \$900 million relates to overdue amounts for revenue forgone on free and reduced rates of postage attributable to Fiscal Years 1991 through 1998 for which the Postal Service provided mail services and incurred costs. Recent events have had a significant impact on the Postal Service's financial condition, causing the Postal Service to freeze capital expenditures, cut administrative staff, and curtail other operating expenses. These funds could be used to alleviate the freeze imposed upon the capital program, with any funds not used for this purpose being applied to the reduction of Postal Service debt. In turn, that would also result in a reduction of Postal Service interest expense.

7. The Service's latest financial and operating statement shows that the Service's expenses for unemployment compensation were about 83% more than planned. Why are these expenses larger than expected?

The Postal Service's unemployment expense for FY 2002 was \$133 million or approximately 107% more than planned. The U.S. Department of Labor (DOL) bills the Postal Service quarterly for unemployment compensation based on state unemployment compensation charges reported by the individual states to DOL. In accordance with Generally Accepted Accounting Principles (GAAP), and per Financial Accounting Standard (FAS) 112, "*Employers' Accounting for Post-Employment Benefits*," the Postal Service must accrue on its books a liability equal to 39 weeks or nine months of unemployment billings.

As of September 30, 2002, the Postal Service's total unemployment compensation liability was \$104 million compared to \$53 million at September 30, 2001. This increase primarily related to the effects of the unemployment compensation bill signed by President Bush in March of 2002, which increased the amount of time an employee can receive benefits by fifty percent—from twenty-six to thirty-nine weeks. In addition, in the aftermath of the terrorist attacks and the resulting drop in mail volume, Postal management challenged field managers to control costs. This resulted in a reduction of over seventy-seven million work hours, which increased the number of employees eligible for unemployment benefits.

8. What is the status of cleanup efforts at contaminated postal facilities in Washington, DC and in Trenton, New Jersey? What will be the final estimated costs for these cleanups? Were these costs paid from the Service's operating revenues or appropriated funds? When do you expect these facilities to reopen?

We are in the final stages of the fumigation effort of the Washington P&DC. It is expected to be ready for final fumigation in December. The New Jersey facility will be approximately 9 months later since the equipment from the DC facility will be taken down and transported to NJ for construction. The actual building fumigation costs will be more than \$100M for both facilities. These costs will be paid for by appropriated funds. Our hopes are that the DC facility will be ready for occupancy by mid- to late-spring of 2003.

General Questions

9. In April of this year, you announced that you were lifting the moratorium on closing post offices and that you planned to close 400-500 post offices this year. What is the status of the number of post offices closed this year? How many post offices in total does the Service plan to close and what is the basis for the decisions on which facilities will be closed?

As of December, the Postal Service has officially closed 213 post offices, all of which had been suspended previously on an emergency basis. There are approximately 346 emergency suspended post offices that are in various stages of the post office closing procedures. We expect these to be completed by the end of 2003. None of these closings affect postmasters' positions.

The Postal Service is currently processing closures of post offices that fall under an emergency suspension situation. Some examples of an emergency suspension situation could be defined as an eviction from a lessor, a safety issue such as a flood, or a building's structural problem.

We are reviewing our entire network to determine how we can best meet the needs of our customers in the most operationally efficient manner.

10. The Service recently filed its first negotiated service agreement request with the Postal Rate Commission. Will these negotiated service agreements give some customers advantages over others? On what basis is the Service deciding what negotiated service agreements to offer and who benefits? What is the expected impact of these agreements on the Service's revenues?

It is not the intent of the Postal Service to create unfair advantages for one company relative to its competitors. In fact, negotiated service agreements will be made available to all "similarly situated" customers, which prevents the Postal Service from arbitrarily favoring one company relative to others. In general, the Postal Service is looking for negotiated service agreements with a number of companies of varying sizes and in a number of different industries. The Postal Service's goals with respect to negotiated service agreements are to craft agreements that benefit the customer but that also produce a net gain in contribution for the Postal Service. The impact of these agreements depends largely on how many can be done and how costly they are to execute. We are hopeful that the Postal Rate Commission and the entire postal community will be able to work with us to establish procedures that make this process more efficient. This would increase the potential impact and also make it easier for smaller companies—who might not be willing or able to pay for lengthy litigation—to participate.

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ON INTERNATIONAL SECURITY, PROLIFERATION
AND FEDERAL SERVICES HEARING
TO RECEIVE THE POSTMASTER GENERAL'S
ANNUAL REPORT TO THE SENATE
SEPTEMBER 27, 2002**

**QUESTIONS FOR THE HONORABLE JOHN POTTER
FROM SENATOR CARL LEVIN**

1. I have made several inquiries concerning the safety of the local post office in Suttons Bay, Michigan. I have heard from a number of my constituents that parking at the facility is inadequate and poses a hazard to customers. While I know that a capital spending freeze is in effect nationwide, I would like the Postal Service to look into these concerns and advise me of your plans and schedule for rectifying the situation.

The Suttons Bay Post Office is located in leased premises in a shopping center, with parking shared with other tenants. During the summer tourist season, parking becomes an issue for all businesses in Suttons Bay. Unfortunately, there is no additional parking available for postal customers or customers of other businesses in the vicinity of the post office. Since the facility itself is adequate and our Greater Michigan District advises that the parking—while posing a problem for all business—does not represent a serious safety issue, replacement of this facility is not authorized during the continuing freeze on facility projects. We will continue to monitor the situation and work with the town to see if alternate parking could be made available.

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**QUESTIONS FOR THE HONORABLE JOHN POTTER
FROM SENATOR THOMAS CARPER**

1. You report that the Postal Service has cut 23,000 jobs and 77 million work hours this year, a year when volume declined but the number of delivery points increased. I understand you plan further cuts next year. What impact, if any, have these cuts had on service? What impact will they have next year when you project an increase in volume?

The reductions in both complement and work hours over the past year have had no adverse impacts on service performance. To the contrary, the Postal Service has not only sustained on-time performance levels but has achieved incremental improvements over Fiscal Year 2001. Through the dedication and hard work of our employees, we anticipate continued improvements in service in the coming year. Our External First-Class (EXFC) scores, i.e., percentage of mail destined for overnight delivery that met its target, were: FY 02 - 93.7%, FY 01 - 93.5%.

2. About 3,000 of the 23,000 positions that have been cut are management and administrative positions at Headquarters and in regional offices. Which crafts did the other 20,000 come from? Has any hiring taken place within any of the crafts this year?

The reduction to complement is illustrated below. All of the reductions came through attrition. The addition of 1.7 million new delivery points has influenced the minimal career hiring in the rural letter carrier and city letter carrier crafts.

NET CAREER COMPLEMENT

MAIL HANDLER	60,102	59,259	(843)	-1.40%
NALC	240,295	233,639	(6,656)	-2.77%
APWU	327,459	313,709	(13,750)	-4.20%
RURAL	59,790	60,817	1,027	1.72%
TOTAL	687,646	667,424	(20,222)	-2.94%

Source: IS.CDB.NORPESF

3. I've heard from letter carriers in my state that a good number of their colleagues work overtime more than once a week. Some blame this on routes being too long; others say there just aren't enough letter carriers. How does letter carrier overtime work? How frequently do letter carriers work overtime? How frequently do employees in other crafts work overtime? How much money is spent each year on overtime? Is there a plan in place to reduce the amount of overtime employees take?

Q 3.1 - How does letter carrier overtime work?

The City Delivery routes are established through the route inspection process. Route inspectors evaluate a route's workload (volume and possible deliveries) and the actual time used for a six-day period, as well as an eight-week randomly selected period. The averages from these two periods are reviewed and the most representative time for the route is determined. Based on the fact that averages are used, there will be some days that are going to have heavier volume and some days that will have lighter-than-average mail volume. With the normal mail fluctuations, overtime may be needed for a carrier to complete their assignments. In addition to the volume fluctuations, there are also vacant assignments daily, due to scheduled and unscheduled leave, in which carriers working fewer than eight hours on some routes and carriers working overtime on other routes may be used to cover these assignments.

The National Association of Letter Carriers (NALC) and the Postal Service have negotiated a set of rules to monitor and govern the application of overtime within a delivery unit. These rules are part of the National Agreement (Article 8), between the parties and can be provided if requested. These rules allow the carriers to sign-up voluntarily for two different types of overtime lists on a quarterly basis (Overtime Desired and Work Assignment).

Q 3.2 - How frequently do Letter Carriers work overtime?

This will vary from site to site based on several factors such as: the mail volume fluctuations, the coverage factor (number of stops receiving mail on a particular day), scheduled and unscheduled leave, the knowledge of the carriers serving the routes, and the number of carriers available on the overtime lists. The weekly average for city letter carriers' overtime is 4.76 hours, per carrier.

Q 3.3 - How do employees in other crafts work overtime?

Each craft has a set of rules that have been negotiated between the parties for those crafts and the Postal Service. It is a similar process for determining the need for overtime, which would normally take into consideration the mail volume fluctuations, scheduled and unscheduled leave, the knowledge of and job qualifications of the staff available, and the number of employees available on the overtime lists.

Q 3.4 - How much money is spent each year on overtime?

City delivery carriers used approximately \$1.6 billion in overtime during FY 02. There are approximately 233,000 city delivery carriers.

Q 3.5 - Is there a plan in place to reduce the amount of overtime employees take?

The Postal Service is continually working on becoming more efficient and effective in our daily operations and the reduction of overtime is one of the main items constantly under review at all levels of the organization. The evaluation of delivery routes and staffing receive continuous review. The Postal Service has implemented strategies to perform route inspections and minor adjustments and to identify and reduce unscheduled absences in an effort to reduce the overtime in delivery operations. As a result of these initiatives, the Postal Service reduced its city delivery overtime by 10.9% in FY 02 compared to the previous year.

4. I know that the only money the Postal Service is spending on facilities right now is to pay for what are essentially emergency health and safety related projects. What kinds of construction or improvement projects have been delayed or canceled because of the Postal Service's financial situation? When do you predict that you'll be able to start on some of them? How has the freeze on new facilities spending affected service?

The hold placed on most capital investments in April 2001 continues. However, items meeting the exception criteria of life, safety, and legal obligations or investments expected to produce a high return on investment (ROI) are being approved. In FY 2002, the Postal Service committed \$244.2 million for investments in support of its facility program and has planned commitments of \$755 million in FY 2003. Additionally, repair and alteration expenses valued at \$165.9 million were incurred in FY 2002.

The Postal Service has had an active, well planned facility program and therefore the freeze has been manageable thus far. Because of growth in some areas, however, it will be necessary to consider new construction where it is no longer viable to sustain postal operations with the current infrastructure. Accordingly, in FY 2003, the facility criteria were expanded to address high growth areas, facility obsolescence, and necessary maintenance on our real property assets.

The Postal Service is in the process of evaluating the totality of its network, including its current infrastructure. Therefore, Postal Service plans beyond FY 2003 also will assume criteria for facility-related investments that concentrate on crucial infrastructure replacements, particularly in high-growth areas. It is expected that future projects will be reviewed on a case-by-case basis.

5. The Postal Service filed its first negotiated service agreement with the Postal Rate Commission this month, with Capital One. I have not seen any dissenting opinions and the Commission has not ruled yet but it appears that what you filed is probably the kind of arrangement that is allowed under current law. Is there anything you wanted to do in your agreement with Capitol One that you felt would have benefited the Postal Service and your customers but would not have been allowed under current law? What kinds of changes, if any, would you like to see in the laws governing these kinds of agreements?

One of the reasons for our filing the negotiated service agreement with Capital One was to test what can be accomplished under the law. Of course there were, and are still, a number of unknowns. One of the issues we face is that the uncertainty associated with the outcome, combined with the time and expense required for the customer to litigate the case at the PRC,

makes it difficult for a number of companies to contemplate NSAs. Capital One can afford lengthy and costly litigation, where smaller companies might not be able to. We do hope that the process will accommodate a more efficient, cost-effective approach to these cases, but this is also an area where some legislative change might prove beneficial.

6. The Postal Service is criticized from time to time for the amount of money it spends on advertising, most recently for its sponsorship of the U.S. cycling team. How much does the Postal Service spend each year on advertising? How much does each class of mail contribute to your advertising budget? Is there any data available on how effective your advertising strategy has been at increasing revenue?

Q 6.1 - How much does the Postal Service spend each year on advertising?

The following is actual advertising spent from FY 1998 – FY 2002, with the budgeted amount for FY 2003:

FY 1998 - \$292MM
 FY 1999 - \$241MM
 FY 2000 - \$158MM
 FY 2001 - \$148MM
 FY 2002 - \$135MM
 FY 2003 - \$ 99MM

Q 6.2 - How much does each class of mail contribute to your advertising budget?

In FY 2000, \$41.621 million was considered incremental to Priority Mail; \$14.459 million was considered incremental to International Mail; \$13.523 million was considered incremental to Other Special Services; \$6.781 million was considered incremental to Standard Mail, \$5.705 million was considered incremental to Express Mail; \$5.276 million was considered incremental to Money Orders; \$289 thousand was considered incremental to Post Office Boxes; \$126 thousand was considered incremental to Parcel Post; and \$27 thousand was considered incremental to First-Class Mail. The remainder of advertising costs in FY 2000 were considered institutional costs—not product specific.

Q 6.3 - Is there any data available on how effective your advertising strategy has been at increasing revenue?

The nature of advertising makes it difficult to measure whether there is a direct correlation between advertising expenses and revenue increases. Currently the Postal Service is spending money on advertising to make consumers aware that stamps are available at venues other than at post offices. In line with the *Transformation Plan*, the Postal Service is trying to take simple transactions, such as the purchase of stamps, out of post office lobbies. The intent of the campaign is cost avoidance.

The Postal Service's advertising effectiveness is measured by an independent marketing research firm which is not associated with Postal Service advertising agencies. The company is contracted by the Postal Service to conduct Sales Response Modeling and to provide pre-concept and in-market performance measures of Postal Service advertising effectiveness. Although the reports from this company are proprietary, Postal Service staff is available to meet with the committee to further discuss advertising expenses.

7. You've said that the Postal Service is in the midst of studying its transportation network. What are the factors that determine what mode of transportation the Postal Service uses to ship between facilities? What is the overall truck volume (non-delivery vehicles)? What percentage of shipments are intermodal, involving truck and rail? Are any shipments exclusively rail-based?

Service and cost are the factors that are considered during mode selection. Fifty-five percent (based on expenses) of standard and periodical mail is transported via Highway Contract Route (HCR). Since September 1, 2002, approximately 32% of Standard and Periodical Mail dispatches are intermodal. Most rail dispatches require highway drayage to rail yards or terminals.

8. What are the general pricing dynamics of intermodal shipments vs. all-truck shipments? Does the Postal Service save money by shipping by intermodal rail?

Rail and truck pricing is not influenced by the mode of transportation selected as much as it is influenced by the market being served and the distances traveled. Market analysis and competitive solicitations have demonstrated that both rail and HCR prices vary by market. Neither mode can claim an absolute price advantage over the other.

9. Describe the Postal Service's working relationship with Amtrak. Are they providing good service? Would a shutdown of Amtrak's national system or long distance trains disrupt service or cause the Postal Service to incur more cost?

Our working relationship with Amtrak is cordial and professional. Our performance information indicates that Amtrak operates 80% on time. A shut down of Amtrak's national rail system would temporarily disrupt service in some markets and could result in the Postal Service incurring additional cost. It is estimated that that cost impact would be minimal.

10. Can the Postal Service increase the amount of traffic it ships by rail, either by Amtrak or freight carrier? Recognizing the cost efficiencies, environmental benefits, and the opportunity to reduce truck traffic, should Congress consider ways to help the Postal Service increase its use of intermodal rail?

Our network is properly balanced between highway and rail transportation. The Postal Service does not experience difficulty procuring either rail or highway transportation.

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**QUESTIONS FOR THE HONORABLE JOHN POTTER
FROM SENATOR SUSAN COLLINS**

1. A recent review of academic studies of postal wages by the Institute for Research on the Economics of Taxation ("The Postal Wage Premium: No Wonder the Postal Service Loses Money") concludes that there exists a wide consensus among economists that postal wages are well above (perhaps 20% to 30% higher than) private sector wages for comparable work.

Is this conclusion accurate in your view?

The Postal Service provided wage comparability evidence most recently during the 2001 Goldberg Interest Arbitration proceedings with the American Postal Workers Union (APWU) and the 2002 Wells Interest Arbitration with the National Rural Letter Carriers' Association (NRLCA). We believe that the economic provisions of both arbitration awards take into account our comparability evidence. The wage premium estimates cited by the Institute for Research on the Economics of Taxation are consistent with some of the evidence presented by the Postal Service during both the APWU and the NRLCA interest arbitrations.

Your Postal Service Transformation Plan mentions labor costs as one of your most pressing problems. What are your plans to address the labor cost issue?

We are aggressively seeking labor cost containment through a variety of measures. These measures include strategies to reduce operating costs by automating the flat mailstream and mail forwarding operations; continuing to improve productivity through techniques such as benchmarking, standardization of best practices, and complement planning and scheduling; exploring new workshare and mail preparation opportunities to eliminate handlings in the presort-to-delivery supply chain; and experimenting with new methods of reducing the time letter carriers spend in the office. We also plan to reduce workers' compensation costs by implementing programs and developing employment opportunities for injured workers within and outside the Postal Service and by working with the Department of Labor on new initiatives and regulatory changes.

Would addressing the labor cost issue involve pay adjustments over time? Staffing changes?

Through a combination of negotiated agreements and interest arbitration awards, the Postal Service has been addressing the labor cost issue with pay adjustments. As an example, the recent round of both negotiated and arbitrated agreements with our four major unions contained lump sum payments in the first year of each respective contract. Since lump sum payments do not become a part of the employee's permanent salary, ongoing labor costs were moderated. In addition, the agreements contained modifications to the cost-of-living allowance (COLA) formula. These modifications also served to address the labor cost issue. The Postal Service anticipates that it will continue to seek modest pay adjustments over time as a means to address labor costs.

As for staffing changes, the career complement was reduced by 23,000 through attrition in FY 2002, and the total complement is less today than it was in 1995. Future staffing savings are anticipated based on measures as summarized in the *Transformation Plan*, such as optimization of the retail network, use of a more flexible workforce, shifting simple transactions away from the counter, using better customer traffic data and improving staff scheduling.

2. What can Congress do to help make your current operations more efficient?

Work with the Postal Service on meaningful postal reform legislation that preserves universal service and provides pricing flexibility and better control over employee compensation outcomes.

Our most critical legislative need, at this time, is statutory change to our Civil Service Retirement System (CSRS) payment schedule. If Congress approves statutory change to the payment schedule, it would add \$2.9 billion to our bottom line in FY 2003 and another \$2.6 billion in FY 2004.

At GAO's request, OPM actuaries analyzed our financial records and discovered that the Postal Service has nearly fully funded its CSRS obligations and will exceed that obligation on its current payment schedule. OMB and the Department of Treasury have validated OPM's analysis.

With this change, rates could remain stable until at least 2006 and debt reduced by more than \$3 billion in FY 2003, compared to the planned debt reduction of \$800 million. Without prompt statutory change, our customers would overpay retirement costs, and we would be forced to file a rate case next spring in order to implement a rate increase in 2004. Failure to pass this legislation could have far reaching economic effects on the \$900 billion mailing industry.

3. Are there work rules or other constraints imposed by law that prevent USPS management from increasing productivity and efficiency that you would like to see changed?

To meet the fundamental challenges facing the Postal Service, some moderate regulatory and legislative reforms must be adopted to assist the Postal Service to increase productivity and efficiency. These reforms will allow postal management to test new opportunities, to prepare for transformational reforms that will be needed in the future, and to enable it to provide service in a less constricted environment.

Without greater flexibility to adapt and change, the traditional network will grow increasingly obsolete and needlessly expensive, draining postal resources that could be used to improve the Postal Service's overall ability to serve the American public.

Recognizing that there are a growing variety of channels through which the Postal Service can provide high-quality services to its customers, the organization will begin to adjust its retail network of facilities to offer alternative, less expensive customer access.

Reforms fall into four categories:

Maximum flexibility with the current rate-making process:

The Postal Service has made a number of proposals to the PRC regarding Negotiated Service Agreements, targeted pricing incentives, experimental classification, and phased rates. If it is determined that such proposals cannot be accommodated within current legislation, additional legislative changes will be proposed.

Rationalize retail network facilities:

Today, we are fortunate to have a number of attractive and convenient alternatives for delivering postal services. Our philosophy behind convenient service access requires that we locate our services where people live, work and shop, providing a wide range of postal services through a wide range of options.

Our consumer access strategies include using our rural letter carriers to serve, essentially, as post offices on wheels. Through rural carriers, customers can purchase stamps and receive virtually any service provided through a regular post office. In addition, we are reaching out to customers in new ways. For example, nationwide more than 4,400 grocery stores, university campuses, and banks sell postal services. Many offer the extended hours that busy people prefer. You can also purchase stamps by mail, by phone and, of course, through the Internet. Every day, an average of 1,500 new users place postal orders over the Internet. We also have the option of providing vending equipment and other self-serve options.

Adopt more businesslike supply chain management practices:

Consistent with the way businesses purchase goods and services, the Postal Service has revised its purchasing regulations to the extent allowed by present law. The Postal Service is working on further revising regulations to allow the purchase of goods and services under policies that will lead to favorable long-term relationships with important suppliers, that will result in more expeditious purchases at superior, overall values and lower administrative costs, and that will allow for dispute resolution with less litigation.

Reform labor and employment provisions:

Labor agreements are, by far, the largest single element of the Postal Service's costs and therefore the primary determinant of prices and the key factor in the Postal Service's overall financial viability. The Postal Service believes that laws should be amended in the near-term to increase the opportunity for the parties to resolve contract disputes themselves instead of relying on an outside arbitrator to determine the final labor agreement.

4. What are some of the restrictions that are preventing you from streamlining your workforce?

During FY 2002, the Postal Service has been very successful in streamlining its workforce by 23,000 employees, entirely through attrition. We also cut 77 million work hours, with no adverse impact on service. Nevertheless, there are some provisions of employee agreements and statutes that restrict our ability to improve productivity and efficiency. For example, statutory reduction-in-force provisions for preference-eligible postal employees renders streamlining the workforce difficult. Voluntary Early Retirement Authority (VERA), which can only be implemented after a request to and approval by the Office of Personnel Management, is a process the Postal Service anticipates seeking authority to use to assist in this effort.

5. Does the Postal Service routinely assess the market value of the individual properties it owns?

The Postal Service does not routinely assess the market value of the individual properties it owns. We follow Generally Accepted Accounting Principles, which require that we carry the assets on our books at the lower of either cost or fair market value. To the extent that we have property, whose value has been impaired and is now less than cost, we have taken a charge against earnings and written the property down to its market value, as required by Financial Accounting Standard # 144.

6. Could profits from asset sales be used to fund needed capital improvements without added borrowing, or to pay down some of the \$12 billion Postal Service debt to the Treasury?

Postal Service policy is to make any excess cash available to fund capital improvements and reduce debt. However, gains (or losses) from the disposal of assets are nominal relative to these expenditures. In the last two years, disposal of land and buildings has yielded proceeds of less than \$30 million.

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**QUESTIONS FOR THE HONORABLE JOHN POTTER
FROM SENATOR ROBERT TORRICELLI**

With regard to the Trenton Mail Processing Center in Hamilton, New Jersey

1. Will all of the employees that were employed at that facility on the date of the anthrax closing, on October 18, 2001, be returned to Hamilton Township when the facility is decontaminated?

Except for the Computerized Forwarding System (CFS) unit employees, which we were previously planning to consolidate into the New Brunswick CFS unit, our plans are to return all other operations to the Hamilton Township facility.

2. Does this include the entire Tour 3 operation, the CFS (central forwarding system) unit and other related operations?

The CFS unit will not be returned. Current plans are to return all other operations to the Hamilton Township facility.

3. Can you elaborate on what the decontamination process will include?

The use of Chlorine Dioxide (CLO2) was recommended as the choice of fumigant by the Environmental Protection Agency following the decision to use the process at the Hart Senate Office Building.

First, CLO2 is a well-known chemical that has been safely and widely used for more than 70 years to disinfect the nation's food and water. More than 900 water treatment facilities worldwide use the chemical every day. There are well-established standards for safe exposure to chlorine dioxide, as established by OSHA.

Second, we have practical experience with the appropriate use of this gas, based on the results of the Hart Building fumigation. In addition, on July 29, we successfully tested a limited application of chlorine dioxide to the most contaminated section of the building—Line 17. The results of this test confirmed the effectiveness of this treatment process.

Third, we have carefully sealed every opening and crack in the building, and all possible escape routes for the gas, to ensure that during fumigation, the gas stays where it's needed – inside the building. In addition, we have conducted multiple validations of the sealing process using a non-hazardous substance to ensure there are no leaks.

Fourth, during the fumigation process we will keep the facility at a modest level of negative pressure. Thus if any leak were present, it would draw air in rather than expel the fumigant out.

Fifth, multiple layers of monitoring, including the EPA Trace Atmospheric Gas Analyzer (TAGA) bus, are in place to monitor the air in the area surrounding the building. The triggering level for these monitoring devices is set at 25 parts per billion (ppb) in a 15-minute time period. This compared to an OSHA short-term exposure limit of 300 parts per billion (ppb) in the same 15-minute period, as well as the permissible exposure limit of 100 parts per billion (ppb) averaged over an 8-hour period. Our limits are significantly stricter than the standards established by OSHA.

Sixth, if a chlorine dioxide leak were detected, the gas emitters would be immediately shut down, the gas would be neutralized, and fumigation would stop until the problem was fully resolved. Already, we have successfully tested a number of the neutralization systems, including the scrubber system, to insure their efficiency in removing the gas from the building via the air vent system.

In addition, this gas dissipates quickly and decays rapidly in sunlight. Left contained in the facility, even at peak fumigation levels, the gas would decay to safe levels within 6 hours.

We take these safety issues very seriously. The tests we have conducted at this facility—both of the decontamination process and the scrubber system—have been successful.

4. Can you elaborate on your efforts to reach out to the unions affected by the anthrax attacks as to your progress as well as your plans for the facility?

Immediately after the anthrax crisis we created a national joint task force that includes participation by our four largest unions. At the outset of the crisis, the task force met daily so all parties could share the latest information and make joint decisions on how to proceed. The task force continues to meet and share information regarding anthrax and other security-related issues.

5. Have there been any provisions made for the employees who have chosen not to return to Hamilton Township?

If employees choose not to return to Hamilton, we will assist them with any requests for transfer in accordance with the provisions of our collective bargaining agreements.

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QUESTIONS FOR THE HONORABLE JOHN POTTER
FROM SENATOR FRED THOMPSON

1. In April 2002, the Postal Service published its Transformation Plan describing the immediate steps that the Service must take now and longer term options to transform the Service. This plan was published after the Service's Strategic Plan (published in September 2000) and its Fiscal Year 2003 Performance Plan (published in September 2002). How would you describe the relationship between the Postal Service's Transformation Plan and its strategic and annual performance goals, indicators, and targets?

The *Transformation Plan* is built on the Postal Service's past strategic plans and goals and is fully consistent with the goals and objectives described in the *Five-Year Strategic Plan, FY 2001-2005*. The *Transformation Plan*, however, identifies very specific near-term initiatives and organizes them under overarching categories that are divided into strategies and sub-strategies, many of which have been identified as previous strategic goals. New strategies outlined in the *Transformation Plan* that could affect postal strategies, programs, and performance in FY 2003 were incorporated into the *FY 2003 Annual Performance Plan*. The *Transformation Plan* also includes recommendations for structural change that would require legislative action.

2. What changes have you made, or are you planning to make, to the Postal Service's strategic and annual performance goals and the strategies to achieve those goals as a result of the Transformation Plan?

The *FY 2003 Annual Performance Plan* incorporated a new objective, new indicator, and new target to reflect the revenue generation initiatives in the *Transformation Plan*. The target for Total Factor Productivity was also adjusted.

The Postal Service *Five-Year Strategic Plan-FY 2001-2005*, is currently being updated, as required by the Government Performance and Results Act of 1993. It will be published in September 2003. Postal management is reviewing the strategic goals, short-term objectives, indicators, and targets as a result of *Transformation Plan* initiatives and expected changes in the business environment.

Current goals—Grow Revenue, Develop Motivated and Committed Employees, and Provide Affordable Service—will not change. Current Objectives—Timely and Reliable Delivery, Minimize Impact for Accidents and Illnesses, Employees Committed to Postal Service Success, and Improve Productivity—are also not likely to change. New goals and objectives may be added to track performance on new or different areas of emphasis and will be reflected in the September 2003 update of the *Five-Year Strategic Plan*.

3. According to the Transformation Plan, enhancing the Postal Service's performance-based culture is one of the plan's initiatives. How are you linking employee performance to the Service's performance goals?

A new executive incentive plan has been approved for 750 executives and officers for FY 2003. Supervisors, postmasters and others represented by the three postal management associations will be considered for participation in FY 2004 following statutory pay consultations.

The new executive incentive plan contains pre-established goals covering a balanced scorecard of performance measures (see table below). Various performance levels have been defined for each executive to encourage continuous efforts at break-through performance. Future incentive payments will be based on customer service, employee commitment, productivity and revenue improvements. The funding pool will follow a budget approach of a percentage of all career, executive, and officer salaries based on performance achieved. This funding approach is similar to the approach the federal sector follows for performance award bonuses for Senior Executive Service employees.

FY 2003 Goals, Sub Goals, and Indicators

	Goal	Sub Goal	Indicator
Voice of Customer	Growth	Timeliness and Consistency	Priority Mail On Time – Surface Network
			Priority Mail On Time – Air Network
			Express Mail On Time
			First-Class Mail On Time – Overnight Commitment
			First-Class Mail On Time – 2 Day Commitment
			First-Class Mail On Time – 3 Day Commitment
Voice of Employee	Motivated, Productive and Inclusive Workforce	Minimize Impact from Accidents and Absences	OSHA Illness/Injury Rate
		Employee Committed to USPS Success	VOE Survey
Voice of Business	Affordability	Improve Productivity to Control Costs and Improve Contribution Levels and Grow the Business	National Total Revenue
			Total Factor Productivity

4. Since 1991, the Postal Service has had a customer satisfaction measure. However, this measure is absent from the Postal Service's Fiscal Year 2003 Performance Plan. Will the Postal Service be continuing to measure customer satisfaction or has it been dropped? If it has been dropped, please explain why the measure was dropped.

The Postal Service continues to measure and report customer satisfaction. In FY 2002, customer satisfaction was an indicator under the Merit Process. In FY 2003, measures of customer satisfaction will be a target for many employees under the new National Performance Assessment program.

5. The Postal Service's Inspector General has identified 10 major management challenges facing the Service. These challenges are: physical security and safeguarding the mail; maintaining customer confidence; resolving workforce and workplace issues; controlling costs; protecting revenues; managing acquisitions; leveraging technology; ensuring data integrity and reliability; maintaining information security and customer privacy; and balancing public service and commercial enterprise. How is the Postal Service trying to resolve these challenges and has the Service established goals and measures to assess its progress in resolving these challenges?

Many of the challenges identified by the OIG have already been established as goals and there are measures in place to assess progress. These goals include resolving workforce and workplace issues, controlling costs, leveraging technology, providing employee safety, protecting revenues, and maintaining customer confidence. For example, the *Transformation Plan* targets cost reductions through increased productivity and from structural changes from network assessment and realignment. Technology will be leveraged with increased use of automation, the sharing of administrative services, and customer access to information about products and services via the Internet. Customer confidence will improve as the Postal Service communicates regularly with the public about new features and products designed to improve service, reduce costs, and introduce rates that reflect the value added to the processes.

The *FY 2003 Annual Performance Plan* identified several new management challenges that were also mentioned by the OIG, including providing customer and employee safety from external threats, ensuring data integrity and reliability, maintaining information security, and customer privacy. These issues are being reviewed as part of the management planning process.

The last issue identified by the OIG, balancing public service and commercial enterprise requirements, is the subject of the postal reform discussion. Under current law the Postal Service is mandated to operate in a business-like manner and also to provide universal service at affordable prices. The Postal Service is focusing on core products, both redefining and expanding them to add value to the mail as customers' needs change with new technology and a changing economy.

6. The General Accounting Office released a letter in September (GAO-02-916R) raising concerns about the Postal Service's accounting practices and financial disclosures of post-retirement benefits. As I understand, the Postal Service has reviewed GAO's recommendations for increasing transparency in its financial statements and is currently conducting a reassessment of its accounting treatment. What measures is the Postal Service taking to reassess its accounting practices? What do you see as the timeframe for the resolution of this matter?

Postal Service management continuously monitors the accounting pronouncements relative to its financial reporting responsibilities. As a result of these ongoing reviews, it has determined that it is applying the appropriate accounting principles in a consistent manner. In reviewing its treatment of retirement expenses and post-retirement health benefits, the Postal Service noted that since its original determination on this topic in 1991, there have been no changes in either the Federal Employee Health Benefit (FEHB) plan structure or Generally Accepted Accounting Principles which would cause it to conclude that a better accounting treatment is available. Postal management informed the Board of Governors' Audit and Finance committee of its decision regarding this issue. The Board of Governors' independent CPA firm, Ernst & Young (E&Y), reviewed management's decision and concurred. The Audit and Finance committee also met with the auditors independently for further discussion. Additionally, the Postal Service has received a clean audit opinion each year on its financial statements.

As is proper with multi-employer retirement plans, we will continue to recognize expenses and record the liability each year as it is incurred. Although the Postal Service is not changing its accounting practices, in order to provide more detailed information to the public, the Postal Service plans to expand the relevant comments included in its Management Discussion & Analysis in the Annual Report.

As part of the Postal Service *Transformation Plan*, postal management recognized the need to re-evaluate its retirement costs. The Postal Service is currently the only agency making both principal and interest payments on all of its CSRS obligations, management-granted pay increases for current employees, and government-granted COLA increases for retirees. In a meeting with the General Accounting Office (GAO), postal management asked GAO to ensure that the Postal Service was paying only its fair share of CSRS retirement costs. In response to this request, the actuaries of Office of Personnel Management conducted a study of the Postal Service's historic obligations and contributions to the CSRS pension fund. The study, completed subsequent to the end of FY 2002, was the first to look at postal payments and benefits separately from those of the government as a whole. It concluded that, under the current legislative statute, the Postal Service's retirement obligations were nearly fully funded, and that, without legislative change, the Postal Service would over-fund this obligation by \$71 billion dollars.

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QUESTIONS FOR THE HONORABLE JOHN POTTER
FROM SENATOR CHUCK HAGEL

1. In April 2002, the General Accounting Office (GAO) released a report (GAO-02-365) assessing existing ionizing radiation technologies used by the United States Postal Service (USPS) to irradiate mail. The report discussed some of the limitations of ionizing radiation, including limited penetration, mail damage as a result of extreme heat, and occupational safety hazards related to chemicals used in irradiation.

What efforts has the United States Postal Service (USPS) made to address these limitations? In addition, has USPS considered researching other methods and technologies to improve the efficiency and accuracy of mail irradiation? If so, is the USPS currently reviewing contract proposals for these technologies?

To address the limited penetration issue, the Postal Service worked with the Office of Science and Technology Policy (OSTP) and the Mail Task Force team of experts from the National Institute of Standards and Technology (NIST), Armed Forces Radiobiology Research Institute (AFRRI), Sandia National Labs and the Food and Drug Administration (FDA) to develop protocols to obviate the limitation. For example, mail being irradiated with E-Beam is irradiated from both the top and bottom, and the thickness is controlled, to ensure the penetration depth is not exceeded. In addition, the Postal Service worked with the same team, to develop protocols to use X-Rays, with the higher penetration capability, to irradiate the thicker and larger packaged mail.

While the Postal Service is still working with the same team of experts to reduce damage due to heat, there are a number of changes that were introduced to the protocols to minimize it. First, the irradiation doses were lowered to the agreed upon level, and to minimize accidental overdoses, additional sensors were added to the material handling system at the contractors' facility. Second, to minimize the heat and occupational safety hazards related to chemicals resulting from irradiation, the mail preparation procedures were updated and the double bagging requirement was eliminated to reduce heat and the potential for trapping volatile organic compounds (VOCs). Third, prior to any distribution, the Postal Service Mail Handling Protocols at the V-Street Station have all the returning mail aired out for a day and deodorized prior to being sent to the government mail distribution center for final processing and delivery or pickup.

It should be noted that the protocols and changes were developed, reviewed and tested to ensure their efficacy. The field tests used *B. globigii* (BG) and the results were confirmed at federal facilities using the Ames strain of *B. anthracis* (BA). While the Postal Service has not ruled out other technologies, irradiation remains the only tested and proven method for killing *B. anthracis* spores. As such, the Postal Service is not proposing other technology for the purpose. However, we are continuing to work with the OSTP and the mail task force to reduce the adverse effects associated with mail irradiation. The process optimization is actively being worked toward a modality where most or all of the mail (letters and flats) is treated with X-Rays which is much more benign and should provide for lower temperatures and damage.

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QUESTION FOR INSPECTOR GENERAL KARLA CORCORAN
FROM SENATOR TED STEVENS

Ms. Corcoran, on page one of your testimony you state that the Postal Service Office of Inspector General was created in 1996 with 1 employee. In eight years the number of employees has increased to 725. How much is being spent by the office for oversight activities and for staffing? What is the office's annual budget and where do the funds come from? Also, please provide the Committee with a breakdown of the office staffing by position, meaning how many administrative support people does the office employ, how many investigators, economists, accountants, etc.

Pursuant to the Inspector General Act, 5 U.S.C. App. 3, Sec. 8G, the primary purpose of the Office of Inspector General (OIG) is to prevent, detect, and report fraud, waste, abuse, and mismanagement, and promote efficiency in the operations of the Postal Service. The OIG is responsible for conducting and supervising all audits of Postal Service programs and operations. The OIG also conducts investigations of Postal programs and operations and has unlimited "oversight" responsibility to examine all activities of the Postal Inspection Service, 5 U.S.C. App 3, Sec 8G(f)(2).

The OIG is independent of Postal management and reports to Congress and the nine presidentially appointed Governors. The goal of the OIG is to independently identify opportunities to reduce costs, streamline operations, support the goals of the Postal Service, and ensure that the Governors are kept fully aware of all emerging issues and significant events.

The OIG is in its sixth year of operation and currently has an annual operating budget of \$117.3 million, which was approved by the Governors. Total personnel costs are estimated at \$79.3 million. Funding for the OIG comes from the general revenues of the Postal Service.

The OIG presently has a total of 725 employees which includes:

- 166 investigators and investigations related staff;
- 474 audit, evaluations, and audit related staff;
- 58 mission support staff (human resources, finance & budget, and technology support); and
- 27 office support staff.